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87-1160

No.

In The Supreme Court of the United States

OCTOBER TERM, 1987

DUQUESNE LIGHT COMPANY
AND
PENNSYLVANIA POWER COMPANY
Appellants,

v.

DAVID M. BARASCH,
CONSUMER ADVOCATE, ET AL.
Appellees.

On Appeal from the Supreme Court of Pennsylvania

APPELLANTS' APPENDIX TO JURISDICTIONAL STATEMENT

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APPENDIX A

Opinion of the Pennsylvania Supreme Court

David M. BARASCH,

Consumer Advocate,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION.

Appeal of EQUITABLE LIFE ASSURANCE SOCIETY, Joseph Horne Company, Kaufmann's and Gimbels.

David M. BARASCH, Consumer Advocate, Appellant,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION.

Supreme Court of Pennsylvania.

Argued March 11, 1987.
Decided Oct. 15, 1987.

[Summary by West Publishing Co.]

Pennsylvania Office of Consumer Advocate appealed from final order of the Public Utility Commission, which permitted inclusion of costs of construction for cancelled nuclear plans in electric company's rate base. The Commonwealth Court, No. 553 C.D. 1983, and No. 1364 C.D. 1984, Barry, J., 90 Pa.Cmwlth. 98, 494 A.2d 58, affirmed in part and reversed in part. The Office of Consumer Advocate petitioned for allowance of appeal. The Supreme Court, No. 33 W.D. Appeal Docket 1986, No. 34 W.D. Appeal Docket, 1986, Nix, C.J., held that: (1) electric utilities were prohibited from recovering costs of cancelled nuclear plans from ratepayers, either by making such costs part of their rate base or by converting them into operating expenses through amortiza-

tion; (2) vacant real estate owned by utility, which might not be developed by utility for next ten years, could not be included in its rate base; (3) statute, which prohibited electric utilities from recovering costs of cancelled plans from ratepayers, did not result in unconstitutional confiscation of utilities' property; (4) statute did not violate constitutional provision, requiring that bill's subject be clearly expressed in its title; and (5) statute did not violate electric utilities' right to equal protection of law.

Reversed and remanded.

OPINION

NIX, Chief Justice.

Before us are two consolidated appeals questioning the right of a public utility to recover certain costs from its ratepayers. We are called upon to decide whether section 1315 of the Public Utility Code ("Code"), 66 Pa.C.S. § 1315, bars an electric utility from amortizing costs incurred in connection with plant-construction projects which were cancelled prior to completion, and whether, if the statute must be so read, it violates constitutional safeguards. We must also determine whether vacant land, purportedly held by a utility company "for future use," is properly includible in its rate base.

In 1973 the Central Area Power Coordinating Group ("CAPCO"), a group of various electric utility companies,[1] formulated a plan to construct seven nuclear electric plants. By 1977, despite considerable public opposition, CAPCO had forged ahead with the construction projects. In 1979 the Pennsylvania Public Utility

[1]The members of CAPCO were: Duquesne Light Company, Pennsylvania Power Company, Cleveland Electric Illuminating Company, Ohio Edison and Toledo Edison.

Commission ("Commission"), on its own motion, began an investigation of the CAPCO program because of delays and other construction problems that were afflicting the projects. In January of 1980, about six months after the Commission had begun its investigation, CAPCO announced that construction would be cancelled on four of the seven nuclear plants.[2] The reasons assigned for that decision included: growing political and regulatory uncertainties arising from the nuclear accident at Three Mile Island, serious financial constraints of various CAPCO members, and a reduced need for additional future generating capacity.

The Duquesne Light Company ("Duquesne") had joined CAPCO in 1967, and was a substantial participant in the group's plant construction venture. Duquesne's share of the construction costs of the four cancelled plants was $34,697,389. In 1980, after the cancellation, Duquesne instituted rate proceedings before the Commission; and thereby sought the right to amortize, over a ten-year period, the construction costs it had borne with respect to the four plants. The same request was made in 1981. However, in each of those rate proceedings the Commission deferred ruling on the request until it received a report relative to its ordered investigation of CAPCO's construction problems.

In April 1982 Duquesne again came before the Commission. This time the company filed a tariff which proposed a change in its rates to increase its annual electric revenues by more than $165,000,000. In conjunction, the utility once more sought to amortize its expenditures on the cancelled plant projects. Several parties appeared in opposition to Duquesne's request, including

[2]The four cancelled projects were: Davis-Besse Units 2 and 3; and Erie Units 1 and 2.

the Office of the Consumer Advocate and several commercial complainants.[3] On October 15, 1982, during the pendency of the proceedings last mentioned, an Administrative Law Judge ("ALJ"), Joseph P. Matuschak, filed with the Commission the awaited investigation report.

The ALJ's "Report of Investigation" set forth his findings and recommendations concerning the CAPCO projects and Duquesne's participation therein. Among his determinations were the following: (1) that Duquesne acted prudently in joining in the ownership of the nuclear plants; (2) that the decision to delay until 1980 the cancellation of the four plants in question was prudent; and (3) that the interim decisions regarding the cancelled plants were prudent. In light of these findings or conclusions, ALJ Matuschak recommended that the Commission allow Duquesne to amortize, in rate proceedings over a period of ten years, its share of the construction costs of the four cancelled units. That recommendation, if accepted, would permit Duquesne to include in its reported operating expenses an additional $3,469,739 for each of the ten years of amortization.

On December 30, 1982, while the Duquesne rate case was still before the Commission, Act No. 335, P.L. 1473, was enacted into law. That statute amended the Public Utility Code by adding thereto section 1315. In parts here pertinent, the text of Act No. 335 is as follows:

AN ACT

Amending Title 66 (Public Utilities) of the Pennsylvania Consolidated Statutes, providing *a limitation on the consideration of certain costs in the rate base* for electric public utilities.

[3] Equitable Life Assurance Society, Joseph Horne Company, Kaufmann's, and Gimbels.

The General Assembly of the Commonwealth of Pennsylvania hereby enacts as follows:

Section 1. Title 66, act of November 25, 1970 (P.L. 707, No. 230), known as the Pennsylvania Consolidated Statutes, is amended by adding a section to read:

§ 1315. Limitation on consideration of certain costs for electric utilities.

Except for such nonrevenue producing, nonexpense reducing investments as may be reasonably shown to be necessary to improve environmental conditions at existing facilities or improve safety at existing facilities or as may be required to convert facilities to the utilization of coal, *the cost of construction or expansion of a facility* undertaken by a public utility producing, generating, transmitting, distributing or furnishing electricity *shall not be made a part of the rate base nor otherwise included in the rates charged by the electric utility until such time as the facility is used and useful in service to the public.* Except as stated in this section, no electric utility property shall be deemed used and useful *until it is presently providing actual utility service to the customers.*

Section 2. This act shall be applicable to *all proceedings pending before the Public Utility Commission and the courts at this time.* Nothing contained in this act shall be construed to modify or change existing law with regard to rate making treatment of investment in facilities of fixed utilities other than electric utilities.

Section 3. *This act shall take effect immediately.*

APPROVED—The 30th day of December, A.D. 1982.

(Emphasis added.)

On January 28, 1983, almost one full month after the enactment and effective date of the above statute, the Commission entered an order which accepted the

recommendation of the ALJ concerning the ten-year amortization of Duquesne's portion of the construction costs of the four cancelled electric plants. The Commission's order thus meant that in the rate proceeding then before it, and for nine additional years, Duquesne could include in its reported operating expenses a one-tenth amortization charge of $3,469,739. The Commission's order also granted Duquesne leave to increase its electric operating revenues by approximately $105,850,000.

In response to the Commission's order of January 28, 1983, the OCA petitioned for reconsideration and modification, asserting that the order violated the newly-enacted section 1315 of the Code. The Commission granted reconsideration, but proceeded to affirm its order after concluding that section 1315 did not prohibit its treatment of the costs in question. In the Commission's view, the statute was not intended to prevent "the recovery of prudent investment in a plant which is prematurely retired or one which is cancelled by reason of a change in economic circumstances." According to the Commission, section 1315 of the Code only barred adding the costs of incomplete construction to an electric utility's *rate base*, and did not disallow passing those costs on to ratepayers through *amortization*. Regarding the express dictate in section 1315 that such costs "shall not be made part of the rate base *nor otherwise included in the rates charged*" (emphasis added), the Commission opined that the foregoing statutory language was intended solely to prevent the regulatory agency from giving a utility dual benefits of the costs, *i.e.*, including the costs in the rate base *and* in some other rate making process. The Commission further concluded that the proscription in section 1315 was but a mirror of the agency's historic regulatory approach to the costs of construction work in progress.

On May 18, 1983, in response to the Commission's denial of the request for modification, the OCA petitioned the Commonwealth Court to review the Duquesne rate order. A petition for review was also filed, jointly, by the several commercial complainants. The sole issue raised in both appeals was the validity of the Commission's decision to allow Duquesne to recover, in its rates, its share of the costs of the cancelled plants.

In July of 1983 another CAPCO member, Pennsylvania Power Company ("Penn Power"), filed a tariff proposing to raise its annual electric revenues by $19,980,000. In connection with that request Penn Power sought to amortize over a span of ten years the sum of $9,569,665, which represented its share of the costs of the four terminated construction projects. As a further matter, Penn Power sought to add $824,074 to its rate base because of certain investments denominated "land held for future use." This latter item referred to interests in unimproved land held by the utility purportedly for future use as the sites electric substations and transmission wires. According to the utility's projections, the land would be devoted to such uses within the next ten years. Another request made by Penn Power was that it be allowed to normalize the income-tax consequences of a change in depreciation methodology. Each of the foregoing requests was opposed by the OCA.

By an order dated April 11, 1984, the Commission granted Penn Power a rate increase of $15,364,000. Relying on its decision in the Duquesne rate case, the regulatory agency accorded Penn Power the same ten-year amortization right.[4] As for the land investments,

[4]Penn Power received the same favorable treatment in the ALJ's investigation report that Duquesne had been given.

the utility was permitted to include their cost in its rate base. To justify that part of its decision, the Commission pointed to what was described as its traditional policy of allowing such investments to be included in a utility's rate base if the property is held pursuant to a definite plan for its use within a "reasonable time." The agency determined that the land interests in question, though conceivably to remain unused for up to ten years, met that requirement. In this regard, the Commission observed that "historically" land or facilities held by a utility for future use in the public service have been a subject "separate and distinct from that of construction work in progress." In the agency's perception, the legislature did not intend to abrogate that policy in enacting section 1315 of the Code. Penn Power also prevailed on its tax normalization claim.

The Commission's order in favor of Penn Power caused the OCA to file another petition for review with the Commonwealth Court. As in the Duquesne case the challenge was made that the order of the regulatory agency, in its treatment of certain costs incurred by the utility, violated section 1315 of the Code. The OCA also sought reversal of the ruling on the tax normalization issue.

For purposes of argument and disposition the Commonwealth Court consolidated the appeals in the Duquesne and Penn Power cases. Then, by a four to three decision, that court held that the Commission had correctly construed section 1315. *Cohen v. Pennsylvania Public Utility Commission*, 90 Pa.Cmwlth. 98, 494 A.2d 58 (1985). Opining that section 1315 is ambiguous, the Commonwealth Court majority looked first to the title of Act No. 335 as a construction aid. The title declares that the Act provides "a *limitation* on the consideration

of certain costs in the *rate base* for electric public utilities." (Emphasis added.) Of the preceding quoted phrase, the court said that it relates exclusively to the rate base "and not a legislative intent to exclude the costs of cancelled facilities from the revenue or expense factors of ratemaking." *Id.* at 105, 494 A.2d at 61.

The Commonwealth Court thus concluded that the legislature intended the prohibition in section 1315 to apply *only* to rate base considerations, and not at all to expense allowances. As further support of that conclusion the majority opinion cited other, pre-existent provisions of the Code, namely sections 1307 and 1310, 66 Pa.C.S. §§ 1307, 1310. Those two sections, according to the court's reading of their significance to ratemaking, evince a long-standing legislative intention to restrict only the elements of a utility's rate base, not the items that can be allowed as operating expenses. As for the part of section 1315 upon which the OCA relied, *i.e.*, the disjunctive phrase "*nor otherwise included in the rates charged*," the Commonwealth Court agreed with the Commission's view that the phrase was meant only to prevent a utility from gaining dual benefits from the challenged costs.

Having equipped itself with the reasoning described above, the Commonwealth Court affirmed the Commission's orders allowing Duquesne and Penn Power to amortize their respective shares of the costs of the cancelled nuclear plants. The court also affirmed the agency's decision to allow Penn Power to include in its rate base the cost of its investments in the unimproved land, concluding that the property was "used and useful" in the public service. However, the court reversed the Commission as to its grant of Penn Power's tax normalization request.[5]

[5]There was no cross-appeal taken from this part of the court's decision.

The OCA petitioned this Court for an allowance of appeal. Another such petition was filed by the commercial complainants who had joined as parties-appellant before the Commonwealth Court. We granted both petitions, in light of the public significance of the issues presented and implicated. After permitting Dequesne and Penn Power to intervene as appellees, we consolidated the cases for argument and decision.

Urging us to reverse the Commonwealth Court's decision relating to the cancelled plant costs and the land investments, the appellants repeat their arguments based on section 1315 of the Code. The Commission, unsurprisingly asserting that the court below correctly decided both questions, re-expounds the reasoning the agency pursued in making its final adjudications. Giving its reasoning a somewhat different emphasis, the Commission here argues that section 1315 was intended to prevent a utility from *earning a rate of return on such costs*, but not to disallow their *recovery* if the expenditures were prudently made. Contending that its reasoning reflects the legislative intent underlying section 1315, the agency directs our attention to section 520 of the Code, 66 Pa.C.S. § 520, a provision which became effective on October 10, 1985, almost three years after the enactment of section 1315. Section 520(c) provides as follows:

> (c) Regulatory treatment of *costs*.—Notwithstanding any other provisions of this title, *for a generating unit canceled after the effective date of this section*, either voluntarily or by commission order, *an electric utility may be permitted to recover a return of, but not a return on, prudently incurred costs on any partially completed facility when cancellation is found by the commission to be in the public interest*. The burden of proof to show that any costs claimed were prudently incurred shall be on the public utility.

(Emphasis added.) 66 Pa.C.S. § 520(c).

In the Commission's view, the 1985 provision for the recovery of cancelled plant costs indicates that the legislature had the same intent when it enacted section 1315 in December of 1982. The Commission further maintains that, with respect to the cancelled plant costs of Duquesne and Penn Power, its decision to permit recovery through amortization was a discharge of its duty to balance the interests of consumers and utility investors when determining what are "just and reasonable" rates.

The two intervenors, Duquesne and Penn Power, add arguments of a different dimension. The utilities argue that section 1315, if given the construction propounded by the appellants, would violate both the federal and state constitutions. They assert that if not allowed to recover from ratepayers prudently incurred costs of cancelled plant projects, such a ban will amount to a confiscation or "taking" of their property without just compensation. The intervenors also contend that, since section 1315 of the Code applies only to electric utilities, it violates the equal protection clause of the United States Constitution, and the prohibition against special legislation set forth in Article III, Section 32 of the Pennsylvania Constitution. The utilities advance two other constitutional arguments: that section 1315 denies them due process of law because the legislature made it retroactive; and that Act No. 335, which added section 1315 to the Code, violates the state constitution because the title of the Act does not suggest that the legislation encompasses anything other than rate base considerations.[6]

[6] By "title" the intervenors refer to the first five quoted lines of Act No. 335 following the words "An Act." Although the Commission calls that group of words a "preamble," we consider "title" to be the more accurate designation and will refer to it as such. *See generally* Sutherland, *Statutory Construction*, §§ 20:03, 20:10, and 22:08 (4th ed. 1985) (difference between preamble and title).

Statutory Interpretation

We will consider first the competing assertions concerning the proper interpretation of section 1315. As previously noted, the OCA and the other appellants rely on the section's express statement that construction costs "shall not be made part of the rate base nor otherwise included in the rates charged by the electric utility until such time as the facility is used and useful in service to the public." To the appellants the crucial element in that proscription, relative to the instant case, is the phrase *"nor otherwise included in the rates charged."* Because of that phrase, the appellants maintain that section 1315 is a clear statement of a legislative intent to bar electric utilities from recovering the costs of cancelled plants through rates charged to consumers. The Commission asserts that section 1315 suffers from an ambiguity: perceived by the agency as arising from the title of Act No. 335, which describes the legislation as "providing a limitation on the consideration of certain costs in the rate base of public utilities." To the Commission, it is significant that the preceding language mentions only *"the rate base,"* and does not include the more encompassing phrase *"nor otherwise included in the rates charged."* With that perception of an ambiguity the Commission argues that section 1315 requires interpretation; and further argues, along lines we have already mentioned, that the legislature's actual intent is reflected by the more limited terms of the title of Act No. 335.

It is well settled that the object of all interpretation and construction of statutes is to ascertain and effectuate the intention of the legislature as expressed by the words employed. 1 Pa.C.S. § 1921(a); *Commonwealth v. Fisher*, 485 Pa. 8, 400 A.2d 1284 (1979); *Pennsylvania Human Relations Commission v. Alto-Reste Park Cemetery*

Ass'n., 453 Pa. 124, 306 A.2d 881 (1973); *Clearview Bowling Center, Inc. v. Hanover Borough*, 430 Pa. 579, 244 A.2d 20 (1968).

It is fundamental that in ascertaining the legislature's intent, the plain words of its laws may not be ignored. *Stegmaier Estate*, 424 Pa. 4, 225 A.2d 566 (1967). A court may not alter, under the guise of interpretation, the express language and intent of the legislature. *Commonwealth v. Pope*, 455 Pa. 384, 317 A.2d 887 (1974); *see Zimmerman v. O'Bannon*, 497 Pa. 551, 442 A.2d 674 (1982). Thus, where the words of a statute are clear and free from ambiguity, a court may go no further to determine the legislative intent. *Kritz Estate*, 387 Pa. 223, 127 A.2d 720 (1956); *Rich v. Meadville Park Theatre Corp.*, 360 Pa. 338, 62 A.2d 1 (1948); *Commonwealth ex rel. Smith v. Clark*, 331 Pa. 405, 200 A. 41 (1938); *see* 1 Pa.C.S. § 1921(b), (c). It is only when the words of the statute are not explicit that the intention of the legislature may be ascertained by considering other means of statutory interpretation or construction. *Davis v. Sulcowe*, 416 Pa. 138, 205 A.2d 89 (1964); *Commonwealth v. Chester County Light and Power Co.*, 339 Pa. 97, 14 A.2d 314 (1940).

Language is "ambiguous" when it conveys two or more reasonable meanings; or when it is otherwise vague, uncertain or indefinite. See WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY. Of the two statutory phrases respectively championed by the opposing parties, as expressing the legislative intent underlying section 1315, neither of those two wordsets is of itself facially ambiguous. On its face, there is nothing vague or uncertain about the language of the title. The phrase "limitation on the consideration of certain costs in the rate base" clearly describes a specific subject of concern: the impact of certain costs on an

electric utility's *rate base*. If this phrase is read as the controlling expression of legislative intent, it could only mean that the legislature's sole purpose in enacting section 1315 was to exclude the costs of uncompleted construction projects from the utility's rate base. It would then follow that the statute itself was not intended to bar a utility from charging those costs to ratepayers as operating expenses. On the other hand, there is nothing facially vague, uncertain or indefinite about the substantive proscription in section 1315 itself. That proscription clearly conveys but one meaning: that the cost of uncompleted projects shall not only be excluded from the rate base, but shall not, in any way whatsoever, be included in the rates charged.

Thus, the interpretational problem that confronts us here is one arising from an inconsistency of legislative articulation in the same enactment. To solve that problem we need look no further than the rule of statutory interpretation set forth in section 1934 of the Statutory Construction Act of 1972, 1 Pa.C.S. § 1934. This rule mandates that: "[e]xcept as provided in section 1933 of this title (relating to particular controls general), *whenever, in the same statute, several clauses are irreconcilable, the clause last in order of date or position shall prevail.*" (Emphasis added.) Since, in our view, the disjunctive proscription in section 1315 is of itself unambiguous, and since it is positioned after the title of the statute by which it was enacted, the terms of that proscription must prevail over the language of the title as being the expression of legislative intention. Moreover, it is an established principle of our jurisprudence that, where the enacting clause of a statute is clear and unambiguous, the title will not be permitted to contradict it. *Commonwealth v. Magwood*, 503 Pa. 169, 469 A.2d

115 (1983); *American Surety Company's Case*, 319 Pa. 549, 181 A. 364 (1935); *Commonwealth ex rel. The Alliance Petroleum and Coal Co. v. Slifer*, 53 Pa. 71 (1866). The same is true with respect to preambles. *American Surety Company's Case*. Although titles and preambles are accepted aids in resolving ambiguity in an enacting clause, they may not be used to create ambiguity where none exists in the clause.

We therefore hold that section 1315 of the Code must be read as prohibiting an electric utility from recovering the costs of cancelled plants from ratepayers, either by making such costs part of its rate base or by converting them into operating expenses through amortization. For us to reach any other conclusion, we would have to treat as surplusage that part of section 1315's proscription which says: "*. . . nor otherwise included in the rates charged by the electric utility.*" It is well settled that the legislature cannot be deemed to intend that its language be superfluous and without import. *E.g., Colodonato v. Consolidated Rail Corp.*, 504 Pa. 80, 470 A.2d 475 (1983); *Consumers Education and Protective Ass'n. v. Nolan*, 470 Pa. 372, 368 A.2d 675 (1977); *Daly v. Hemphill*, 411 Pa. 263, 191 A.2d 835 (1963); *Commonwealth v. Mack Bros. Motor Car Co.*, 359 Pa. 636, 59 A.2d 923 (1948).

The appellate courts of several other jurisdictions have interpreted their state law as preventing an electric utility from treating as "operating expenses," and thus recovering from ratepayers, the costs of cancelled nuclear projects. One such case is *Office of Consumers' Counsel v. Public Utilities Commission of Ohio*, 67 Ohio St.2d 153, 423 N.E.2d 820 (1981), *appeal dismissed sub nom. Cleveland Electric Illuminating Co. v. Office of Consumers' Counsel*, 455 U.S. 914, 102 S.Ct. 1267, 71 L.Ed.2d

455 (1982). In that case, the state regulatory body granted an electric utility a rate increase of approximately $70,000,000, and, in conjunction, allowed the utility to amortize over a ten-year period its $56,000,000 investment in four cancelled nuclear power plants. The Supreme Court of Ohio reversed the agency's order as to the amortization, holding that to allow the utility to amortize its investment in the terminated projects, and thus permit its recovery from ratepayers as operating expenses, violated state law. The court concluded that under Ohio's rate statute a utility's recoverable costs were limited to those which are ordinary and recurrent in the rendition of service to the public, and that the sunk costs of uncompleted capital projects did not come within that category. In the words of the opinion supporting the court's decision, "what the company sought and what the Commission granted was the amortization *as service-related costs* of an investment that never provided any service whatsoever to the utility's customers." 67 Ohio St.2d at 164, 423 N.E.2d at 827 (emphasis added). The opinion further stated that, in the absence of explicit statutory authorization, the regulatory agency could not benefit a utility's investors by guaranteeing the full return of lost capital at the expense of the ratepayers. *Id.* at 167, 423 N.E.2d at 829. It is worth noting that the utility in the foregoing case, Cleveland Electric Illuminating Company, was a member of CAPCO, and that the four cancelled projects there in issue are the same ones which are involved in the appeals now before us.

The Supreme Court of Wyoming, in *Pacific Power & Light Co. v. Public Service Commission of Wyoming*, 677 P.2d 799 (Wyo.1984), rejected an electric utility's attempt to compel its customers to bear the cost, through

rates, of its expenditures and obligations in connection with cancelled nuclear power construction projects. The electric company, while recognizing that the terminated projects did not constitute "used and useful" property within the meaning of Wyoming's utility statute, nevertheless asserted that the implicated costs were includible in its rate base as prudently incurred operating expenses. The Supreme Court of Wyoming rejected that argument for several reasons, not the least of which was its conclusion that such capital costs did not qualify as "operating expenses," prudent or otherwise. A comparable result was reached by the Court of Appeals of Indiana in the case of *Citizens Action Coalition v. Northern Indiana Public Service Co.*, 472 N.E.2d 938 (Ind.Ct.App. 1984). That court expressly embraced the decisions in *Office of Consumers' Counsel, supra*, and *Pacific Power & Light Co., supra*, as being consonant with Indiana law.

Also deserving of mention is the 1984 decision of the Supreme Court of New Hampshire in *Appeal of Public Service Co. of New Hampshire*, 125 N.H. 46, 480 A.2d 20 (1984). That case, too, involved an attempt by an electric utility to recover from its ratepayers the cost of its financial participation in a subsequently aborted project to build a nuclear generating plant. The utility had become part owner of the project in 1972; and, by 1981, when the project was cancelled, the company's investment in the uncompleted construction was nearly $16,000,000. The New Hampshire court held that, by force of a statute enacted in 1979, such costs could neither be included in the utility's rate base nor amortized as an operating expense. The statutory provision relied on by the court stated that: "At no time shall any rates or charges be based upon any costs associated with construction work if said construction work is not

completed." RSA 378: 30-a (Supp.1981). The same statute continued with the following mandate:

> All costs of construction work in progress, including, but not limited to, any costs associated with constructing, owning, maintaining, or financing construction work in progress, shall not be included in a utility's rate base *nor be allowed as an expense for rate making purposes* until, *and not before*, said construction project is *actually providing service to consumers*. (Emphasis added.)

In our view, the substantive terms of the New Hampshire statute bear a striking resemblance to section 1315 of our Public Utility Code.[7]

The Commission's reference to section 520(c) of the Code is unavailing. It is true that, as a result of the enactment of section 520, electric utilities are *now* permitted to recover cancelled plant costs under certain circumstances and conditions. However, as we have already pointed out, section 520 was enacted in 1985—almost three years after section 1315 was added to the Code. The perceptions and purposes of the legislature in 1985 did not necessarily mirror those which existed in 1982, when section 1315 became law. We have not been presented with any persuasive reason for concluding that they were the same. We are concerned with the legislative intent underlying the 1982 statute, section 1315; for that is the one which applies to the instant matters. We are not here concerned with the legis-

[7]Other appellate courts have held that an electric utility does have the right to amortize the costs of cancelled nuclear projects. *E.g.*, *Attorney General v. Department of Public Utilities*, 390 Mass. 208, 455 N.E.2d 414 (1983); *People's Organization for Washington Energy Resources v. Washington Utilities and Transportation Commission*, 104 Wash.2d 798, 711 P.2d 319 (1985). Such decisions, however, rested on conclusions about the governing statute, *i.e.*, that it did not deprive the regulatory body of authority to allow amortization.

lature's intent, during a later session, in enacting a statute which does not apply to the case before us. Furthermore, any attempt to impute relevance to section 520 cannot ignore the fact that it was made to operate *prospectively only*. Such is an indication that the legislature, in belatedly conferring upon electric utilities a conditional right to recover cancelled plant costs, did not intend for the utilities to have that right prior to the effective date of the 1985 statute.

We turn next to the question of whether the Commission was correct in deciding that Penn Power's rate base could be increased by the amount of its investments in the vacant land. As mentioned, the Commission based its decision on a finding that Penn Power had a definite plan earmarking the unimproved land for use, "within a reasonable time," as sites of transmission lines and substations. The OCA, in disputing the validity of the above ruling, starts with a premise that property owned by a utility may not be included in its rate base unless it is used and useful in the public service. In connection with that proposition, the OCA then focusses on the last sentence of section 1315, which in part here pertinent, states: "[n]o electric utility property shall be deemed *used and useful* until it is *presently providing actual utility service to the customers*." (Emphasis added.) In the view of the OCA, Penn Power's planned, future use of the vacant land did not render it "used and useful" under the standard dictated by the above statutory language. This contention was, as noted, rejected by the court below.

The threshold premise of the OCA's argument concerning the vacant land is legally accurate. One of the cardinal principles of this state's public utility law is that, in the setting of rates for services to the public, a

utility company is entitled to a return only on such of its property as is "used and useful" in the public service. *E.g., Pennsylvania Electric Co. v. Pennsylvania Public Utility Commission*, 509 Pa. 324, 502 A.2d 130 (1985); *Scranton v. Scranton Steam Heat Co.*, 405 Pa. 397, 176 A.2d 86 (1961); *Erie City v. Public Service Commission*, 278 Pa. 512, 529, 123 A. 471, 478 (1924); *City of Pittsburgh v. Pennsylvania Public Utility Commission*, 171 Pa.Super. 187, 90 A.2d 607 (1952); *Newport Home Water Co. v. Public Service Commission*, 76 Pa.Super. 386 (1921); *UGI Corp. v. Pennsylvania Public Utility Commission*, 49 Pa.Cmwlth. 69, 410 A.2d 923 (1980); *see* 66 Pa.C.S. § 1310(d). The fact that a utility owns a property does not of itself justify its inclusion in the rate base; and the burden is on the utility to show that the property is "used and useful" in the public service. *City of Pittsburgh, supra.*

Based on the standard set forth by the final sentence of section 1315 of the Code, as to when the property of an electric utility may be deemed "*used and useful,*" we must conclude that the vacant land here in issue does not meet that test. Utility real estate that is vacant and, according to the utility's own plans, might remain so for as long as ten years, cannot reasonably be characterized as property "*presently providing actual utility service to the customers.*"[8] We thus hold that the addition of the land investments to Penn Power's rate base violated the terms of section 1315 of the Code.[9]

[8]Penn Power's reliance on our decision in *Barasch v. Pennsylvania Public Utility Commission*, 507 Pa. 430, 490 A.2d 806 (1985) is misplaced. In that case we held that a utility could properly include in its rate base the cost of nuclear fuel purchased for use in an uncompleted nuclear plant. However, an important fact in the case was that the fuel could also have been used in other facilities that were currently in service. Utilities have traditionally been allowed to recover the cost of usable supplies and materials.

[9]*See Boston Edison Co. v. Dep't. of Public Utilities*, 375 Mass. 1, 375 N.E.2d 305 (1978) (pointing out that utility was free to sell land at a profit, which would benefit stockholders, not ratepayers).

Constitutional Challenges

According to the intervenors, a statute which disallows inclusion of the cancelled plant costs in the rate base, and also bars as an alternative their being treated as operating expenses, works a confiscation of utility property without just compensation, in violation of the federal and state constitutions.

It is of course true that the property of a public utility, though devoted to the public service and convenience, is still private property; and neither the corpus of that property nor the use thereof can be constitutionally taken for a compulsory price which falls below the measure of just compensation. *E.g., United Railways and Electric Co. of Baltimore v. West*, 280 U.S. 234, 50 S.Ct. 123, 74 L.Ed. 390 (1930). This deeply-rooted principle of constitutional law had been articulated in more abbreviated form in the landmark case of *Smyth v. Ames*, 169 U.S. 466, 18 S.Ct. 418, 42 L.Ed. 819 (1898), in which the Supreme Court of the United States declared that a public utility "may not be required to use its property for the benefit of the public without receiving just compensation for the services rendered by it." *Id.* at 546, 18 S.Ct. at 433. An even earlier formulation of the same precept is to be found in *Railroad Commission Cases*, 116 U.S. 307, 6 S.Ct. 1191, 29 L.Ed. 636 (1886).

The "just compensation" safeguarded to a utility by the fourteenth amendment of the federal constitution is a reasonable return on the fair value of its property at the time it is being used for public service. *Denver Union Stock Yard Co. v. United States*, 304 U.S. 470, 58 S.Ct. 990, 82 L.Ed. 1469 (1938); *Los Angeles Gas Co. v. Railroad Commission*, 289 U.S. 287, 53 S.Ct. 637, 77 L.Ed. 1180 (1933); *McCardle v. Indianapolis Water Co.*, 272 U.S.

400, 47 S.Ct. 144, 71 L.Ed. 316 (1926); *Board of Commissioners v. New York Bell Telephone Co.*, 271 U.S. 23, 46 S.Ct. 363, 70 L.Ed. 808 (1926); *Willcox v. Consolidated Gas Co.*, 212 U.S. 19, 29 S.Ct. 192, 53 L.Ed. 382 (1909); *Pennsylvania Electric Co. v. Pennsylvania Public Utilities Commission, supra.* Thus, the *return* which a utility is constitutionally entitled to earn relates only to its property that is employed in the public service. *Bluefield Water Works Co. v. Public Service Commission*, 262 U.S. 679, 43 S.Ct. 675, 67 L.Ed. 1176 (1923); *Smyth v. Ames, supra; Railroad Commission Cases, supra.* In that regard, the Supreme Court has held that it is only when a utility's property is *"used and useful"* in the public service does the federal constitution require its inclusion in the rate base, upon which the return is calculated. *Federal Power Commission v. Natural Gas Pipeline Co.*, 315 U.S. 575, 62 S.Ct. 736, 86 L.Ed. 1037 (1942); *Denver Union Stock Yard Co. v. United States, supra.* A refined version of the same principle can be found in *Columbus Gas & Fuel Co. v. Public Utilities Commission*, 292 U.S. 398, 54 S.Ct. 763, 78 L.Ed. 1327 (1934). There, the Supreme Court held that a utility's rate base need not include assets not presently in use, *"unless the time for using them is so near that they may be said, at least by analogy, to have the quality of working capital."* *Id.* at 406.

In addressing the confiscation argument, we must recognize that a public utility's constitutional right to "just compensation" encompasses not only rate base considerations, but also includes the utility's right to recover from ratepayers the expenses and costs of operation. *West Ohio Gas Co. v. Public Utilities Commission*, 294 U.S. 63, 55 S.Ct. 316, 79 L.Ed. 761 (1935); *United Railways and Electric Co. of Baltimore v. West, supra; Smyth v. Ames, supra; Covington & Lexington Turnpike*

Road Co. v. Sandford, 164 U.S. 578, 17 S.Ct. 198, 41 L.Ed. 560 (1896). Indeed, a utility's earned return on its rate base is to be measured only after its operating expenses have been deducted from gross revenues; and prescribed rates which are not sufficient to allow recovery of operating expenses, in addition to providing a fair return on the rate base, are confiscatory. *E.g., United Railways and Electric Co. of Baltimore v. West, supra.* However, just as a utility has no constitutional right to have included in its rate base assets which are not "used and useful" in the public service, so too may it be restricted as to what items it can properly claim as operating expenses.

In *Lindheimer v. Illinois Bell Telephone Co.*, 292 U.S. 151, 54 S.Ct. 658, 78 L.Ed. 1182 (1934), the Supreme Court described the "operating expenses" of a public utility as *"the cost of producing the service."* *Id.* at 167, 54 S.Ct. at 665 (emphasis added). The Court, observing that "[c]harges to operating expenses may be as important as valuations of property," pointed out that an improper inflation of operating expenses would produce the same result as an increase of the allowed rate of return on the rate base. *Id.* at 164, 54 S.Ct. at 663. The Court, in *Lindheimer*, went on to hold that the ratemaking authority could properly exclude from a utility's claimed operating expense the amount of excessive depreciation charges. The depreciation charges there involved were deemed excessive because they went far beyond any realistic measure of the degree to which the utility's plant was being consumed by use in the public service. In the case of *Dayton Power & Light Co. v. Public Utilities Commission*, 292 U.S. 290, 54 S.Ct. 647, 78 L.Ed. 1267 (1934), the Supreme Court held that a state, in fixing rates for a utility, may exclude from reported operating expenses unreasonable amounts which the

utility paid to an affiliated company for supplies. *See also Columbus Gas & Fuel Co. v. Public Utilities Commission, supra.* It is thus clear that the federal constitution does not confer upon a public utility the right to claim, for ratemaking purposes, whatever it sees fit to include in the category of "operating expenses." In that regard, the significance of the *Lindheimer* and *Dayton Power & Light Co.* cases may be stated thus: principles of "just compensation" under the federal constitution do not endow a public utility with the right to burden ratepayers with what the utility calls an "operating expense" unless such item, in addition to being reasonable in amount, represents a cost of providing *present* utility service.

We have not been presented with any convincing argument for concluding that the "just compensation" provision of our state constitution compels a broader conception of the nature of an "operating expense." The judicial decisions of this state are not wanting in expressions concerning the type of outlays or cost items which a utility may properly charge to ratepayers as operating expenses. For example, in *Shirk v. Lancaster City,* 313 Pa. 158, 169 A. 557 (1933), this Court generally defined a utility's "operating cost" as including "all charges and expenses involved in the *production, supply and distribution of the commodity.*" *Id.* at 171, 169 A. at 563 (emphasis added).[10] Later, in *Barasch v. Pennsylvania Public Utility Commission,* 507 Pa. 561, 493 A.2d 653 (1985), we indicated that "proper operating expenses" are ones which relate to the *cost of service.* We have also observed, regarding a utility's right to recover expenses, that the

[10]As examples of such expenses, the Court included such items as salaries, telephone, insurance, taxes and stationery.

policy in this state has been for current ratepayers to bear "only the actual expenses of *providing current utility service*" and that such policy was reaffirmed in the enactment of section 1315 of the Public Utility Code. *Barasch v. Pennsylvania Public Utility Commission,* 507 Pa. 496, 516-17, 491 A.2d 94, 104 (1985) (emphasis added); *see also Pennsylvania Electric Co. v. Pennsylvania Public Utility Commission, supra.* These expressions basically coincide with the mentioned federal view of what kinds of costs a utility is constitutionally entitled to pass to ratepayers under the classification of "operating expenses." Therefore, without the benefit of a valid and otherwise applicable statute conferring a broader right, the only expenses which a public utility in this state may recover from ratepayers, through rates, are those expenses which represent the actual cost of providing *present* utility service. That is so regardless of whatever convenient accounting label the utility might employ to characterize a nonqualifying outlay.

It is absolutely clear that the four uncompleted nuclear plants here involved have no capacity to produce any present utility service to the customers of the two intervenors. Those aborted projects are of no use whatsoever to the public. It should be recalled that in *Pennsylvania Electric Co. v. Pennsylvania Public Utility Commission, supra,* we held that a nuclear reactor at Three Mile Island was properly excluded from the utility's rate base because it had been so damaged by a near melt-down as to be useless in the public service. Certainly, no reasonable argument can be made that the four uncompleted plants have any higher degree of usefulness. Given that the terminated plants are so useless as to preclude their being an element of a utility's rate base, we cannot imagine by what magic the inter-

venors' investments in the useless projects can be considered a cost of providing present utility service as to qualify as "operating expenses." We therefore hold that interpreting section 1315 of the Code as barring the amortization of cancelled plant costs does not work an unconstitutional confiscation of utility property.

As a further constitutional challenge, intervenor Duquesne argues that section 1315 is violative of due process standards because it was made to operate retroactively. We reject this argument as being without merit. Neither the federal constitution nor our state constitution invalidates a non-penal statute merely because it is retroactive, unless such legislation impairs contractual or other vested rights. *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1, 96 S.Ct. 2882, 49 L.Ed.2d 752 (1976); *Chase Securities Corp. v. Donaldson*, 325 U.S. 304, 65 S.Ct. 1137, 89 L.Ed. 1628 (1945); *Kentucky Union Co. v. Kentucky*, 219 U.S. 140, 31 S.Ct. 171, 55 L.Ed. 137 (1911); *League v. Texas*, 184 U.S. 156, 22 S.Ct. 475, 46 L.Ed. 478 (1902); *Campbell v. Holt*, 115 U.S. 620, 6 S.Ct. 209, 29 L.Ed. 483 (1885); *Krenzelak v. Krenzelak*, 503 Pa. 373, 469 A.2d 987 (1983); *Smith v. Fenner*, 399 Pa. 633, 161 A.2d 150 (1960). It cannot be said that either Duquesne or Penn Power had a contractual or other vested right to recover from ratepayers the cost of investments which do not provide utility service.

Duquesne also contends that because the title of Act No. 335 does not mention the retroactivity of section 1315 the legislation is invalid. As support for that assertion, the company relies on Article III, section 3 of the Pennsylvania Constitution, which in part states: "No bill shall be passed containing more than one subject, which shall be clearly expressed in its title. . . . " This argument must fail. The preceding constitutional provi-

sion requires merely that the title of a statute put reasonably inquiring minds on notice of the legislation's contents. *In re Condemnation by Commonwealth, Department of Transportation*, 511 Pa. 620, 515 A.2d 899 (1986); *L.J.W. Realty Corp. v. City of Philadelphia*, 390 Pa. 197, 134 A.2d 878 (1957); *In re Gumpert's Estate*, 343 Pa. 405, 23 A.2d 479 (1942). All that is required is that the title shall contain words sufficient to cause one having a reasonably inquiring state of mind to examine the statute to determine whether he may be affected by it. *Boyertown Burial Casket Co. v. Commonwealth*, 366 Pa. 574, 79 A.2d 449 (1951). Although Act No. 335 does not in its title mention the retroactivity of section 1315, such is expressly set forth in the next-to-last part of the Act. We cannot believe that a statute's title which announces that the legislation is an amendment of the Public Utility Code, and which also mentions "*providing a limitation on the consideration of certain costs in the rate base for electric public utilities*," would not induce an electric-utility company to examine and study the entire enactment.

Duquesne and Penn Power join in making the additional assertions that Act No. 335 denies them the equal protection of the laws as guaranteed by the Fourteenth Amendment of the United States Constitution, and that the Act also violates the prohibition against "special legislation" set forth in Article III, section 32 of the Pennsylvania Constitution. These arguments are predicated on the fact that Act No. 335, by its terms, applies only to electric-utility companies, and not to other type public service companies such as gas and water utilities. The intervenors contend that, if the public interest is served by protecting utility ratepayers from being burdened with the costs of unproductive construction

projects, a statute which targets only electric utilities in that regard is an unreasonable, and thus unconstitutional, classification.

The equal protection clause of the United States Constitution requires that " 'all persons similarly circumstanced shall be treated alike.' " *Plyler v. Doe*, 457 U.S. 202, 102 S.Ct. 2382, 72 L.Ed.2d 786 (1982); *F.S. Royster Guano Co. v. Virginia*, 253 U.S. 412, 415, 40 S.Ct. 560, 562, 64 L.Ed. 989 (1920). Among its various applications, the equal protection clause of the federal constitution forbids a state legislature from imposing on a person, natural or artificial, or on a class, burdens which are not cast upon others similarly situated. *E.g., Atchison, Topeka and Santa Fe R.R. v. Matthews*, 174 U.S. 96, 19 S.Ct. 609, 43 L.Ed. 909 (1899). The equal protection of the laws, it has been said, means that the rights of all persons must rest upon the same *rule* under similar circumstances. *Hartford Steam Boiler Inspection and Insurance Co. v. Harrison*, 301 U.S. 459, 461, 57 S.Ct. 838, 839, 81 L.Ed. 1223 (1937); *Louisville Gas & Electric Co. v. Coleman*, 277 U.S. 32, 37, 48 S.Ct. 423, 425, 72 L.Ed. 770 (1928).

The intervenors in the case at bar, in asserting that Act No. 335 denies them the equal protection of the laws, assume that, because the legislation applies exclusively to electric utilities, it will have the effect of requiring only public utilities of that class to bear the burden of aborted construction projects but will permit other type utilities to pass such costs on to their ratepayers. This assumption is palpably erroneous. Given what we have already said about the fundamental principles of this state's public-utility jurisprudence, it should be clear that no utility of any type is permitted, without express and valid legislative authorization, to

charge ratepayers for property which is not used and useful in the production of current utility service. In our view, Act No. 335 was mainly an attempt by the 1982 legislature to make clear, by codification, that the above mentioned general principle of utility law should govern the then-ongoing efforts of some electric utilities to recover cancelled plant costs from their customers.

There is nothing in Act No. 335 to indicate that the legislature which enacted it, after going to such lengths to make it absolutely clear that the Commission had no authority to allow the electric utilities to recover the costs of uncompleted projects, also intended to abrogate pre-existent legal principles which would compel the same result with respect to other type public utilities. Indeed, the very last sentence in section 2 of the Act expressly states: "Nothing contained in this act shall be construed to modify or change *existing law* with regard to the rate making treatment of investment in facilities of *fixed utilities other than electric utilities*." (Emphasis added.) We read this proviso to mean that, although the Act focusses on electric utilities, such does not mean that other type utilities are relieved of the proscriptions of pre-existing law concerning the recovery of costs. Thus, Act No. 335 has no disparate impact on electric utilities; and, for that reason, we conclude that the statute does not deny the intervenors the equal protection of the laws. *See Califano v. Boles*, 443 U.S. 282, 99 S.Ct. 2767, 61 L.Ed.2d 541 (1979); *National Union of Marine Cooks & Stewards v. Arnold*, 348 U.S. 37, 75 S.Ct. 92, 99 L.Ed. 46 (1954). In determining whether the equal protection guaranteed by the federal constitution has been afforded, consideration must be given to the entire body of law operating upon the subject matter in issue. *See Interstate Busses Corp. v. Blodgett*, 276 U.S. 245, 48 S.Ct.

230, 72 L.Ed. 551 (1928); *Farmers and Mechanics Savings Bank v. Minnesota*, 232 U.S. 516, 34 S.Ct. 354, 58 L.Ed. 706 (1914); *see also Louisville Gas & Electric Co. v. Coleman*, *supra*, at 50 (Brandeis, J., dissenting).

Regarding the bar against "special legislation" contained in Article III, section 32 of the Pennsylvania Constitution, this Court has held that the provision, in its meaning and purpose, is sufficiently similar to the equal protection clause of the United States Constitution as to warrant like application. *Laudenberger v. Port Authority of Allegheny County*, 496 Pa. 52, 67 n. 13, 436 A.2d 147, 155 n. 13 (1981); *Baltimore & Ohio R.R. v. Commonwealth, Department of Labor & Industry*, 461 Pa. 68, 334 A.2d 636 (1975). Therefore, the same considerations that invalidate the intervenors' reliance on the federal guarantee also defeat their resort to the analogous provision in our state constitution.

We hold that the Public Utility Commission exceeded its lawful authority in allowing Duquesne and Penn Power to amortize the costs of the cancelled construction projects. We also conclude that the Commission erred likewise in permitting Penn Power to add to its rate base the cost of its investments in the vacant land here involved. It is clear, beyond any need for citation, that the function of ratemaking for public utilities is legislative in nature. The Commission is but an instrumentality of the state legislature for the performance of that function; and the agency has only such powers as are expressly conferred upon it by statute or exist by necessary implication. *E.g., City of Philadelphia v. Philadelphia Electric Co.*, 504 Pa. 312, 473 A.2d 997 (1984). By entering the decisions here reviewed, the Commission not only failed to apply long-established principles

of public utility law, but also failed to heed the legislature's statutory re-confirmation of them with respect to the costs at issue in these cases.

For the reasons set forth herein, the orders of the Commonwealth Court are reversed. These causes are hereby remanded to the Commission for proceedings consistent with this opinion.

APPENDIX B

Opinion of the Pennsylvania Commonwealth Court

Walter W. COHEN, Consumer Advocate, Petitioner,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION, Respondent.

David M. BARASCH, Consumer Advocate, Petitioner,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION, Respondent.

Commonwealth Court of Pennsylvania.
Argued April 10, 1985.
Decided June 13, 1985.
As Amended June 14, 1985.

BARRY, Judge.

553 C.D. 1983

The Office of Consumer Advocate (OCA) appeals a final order of the Pennsylvania Public Utility Commission (PUC) which permitted inclusion in its rate base of the cost of construction of four cancelled nuclear plants by Duquesne Light Company (Duquesne).

In 1967, Duquesne became a member of the Central Area Power Coordination Group (CAPCO)[1] which developed a plan to construct seven nuclear power plants. In January, 1980, CAPCO, however, cancelled plans to construct four nuclear plants. At that time Duquesne's share of the expended cost was $34,697,389.00. In April, 1982, Duquesne requested an

[1]The other members of CAPCO are Pennsylvania Power Company (Penn Power), Cleveland Electric Illuminating Company, Ohio Edison and Toledo Edison.

annual base rate increase of $155,000,000.00 effective June 29, 1982.

In January, 1983, the PUC issued a final order which granted Duquesne $105,850,000.00 on its rate request and allowed an annual revenue of $3,469,739.00 representing the amortization for the first year of a ten year period of the costs of $34,697,389.00 for the four cancelled nuclear plants. Thereafter, the OCA filed for reconsideration and modification based on a newly enacted statute added Section 1315 of the Public Utility Code (Code), 66 Pa.C.S. § 1315,[2] which allegedly disallowed recovery of these plant cancellation costs in rates.

The PUC denied this petition reasoning that Section 1315 was inapplicable to such costs. It held that Section 1315 prohibits the inclusion of the costs of plants not used and useful to the public in rate bases but does not prohibit the inclusion of reasonable costs of these plants in revenues as an expense.

The seminal issue involves whether costs of cancelled nuclear power plants can be included in Duquesne's rates. The resolution of this question depends upon whether Section 1315 prohibits amortization of the cancellation costs. Act 335, adding Section 1315, states as follows:

AN ACT

Amending Title 66 (Public Utilities) of the Pennsylvania Consolidated Statutes, providing a limitation on the consideration of certain costs in the rate base for electric public utilities.

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[2]Act of Assembly No. 335, approved December 30, 1982.

The General Assembly of the Commonwealth of Pennsylvania hereby enacts as follows:

Section 1. Title 66, act of November 25, 1970 (P.L. 707, No. 230), known as the Pennsylvania Consolidated Statutes, is amended by adding a section to read: § 1315. Limitation on consideration of certain costs for electric utilities.

Except for such nonrevenue producing, nonexpense reducing investments as may be reasonably shown to be necessary to improve environmental conditions at existing facilities or improve safety at existing facilities or as may be required to convert facilities to the utilization of coal, the cost of construction or expansion of a facility undertaken by a public utility producing, generating, transmitting, distributing or furnishing electricity shall not be made a part of the rate base nor otherwise included in the rates charged by the electric utility until such time as the facility is used and useful in service to the public. Except as stated in this section, no electric utility property shall be deemed used and useful until it is presently providing actual utility service to the customers.

Section 2. This act shall be applicable to all proceedings pending before the Public Utility Commission and the courts at this time. Nothing contained in this act shall be construed to modify or change existing law with regard to rate making treatment of investment in facilities of fixed utilities other than electric utilities.

Section 3. This act shall take effect immediately.

Our scope of review is limited to a determination of whether constitutional rights have been violated, an error of law committed or whether the findings, determinations or order of the PUC are supported by substantial evidence. *U.S. Steel Corp. v. Pennsylvania Public Utility Commission*, 37 Pa. Commonwealth Ct. 195, 390

A.2d 849 (1978). The interpretation given a statute by the agency charged with its execution and application is entitled to great weight and should be disregarded or overturned only for cogent reasons or if such construction is clearly erroneous. *Chappell v. Pennsylvania Public Utility Commission*, 57 Pa. Commonwealth Ct. 17, 425 A.2d 873 (1981).

The OCA contends that the PUC erred when it construed Section 1315 to allow amortization of the cancellation costs. It asserts that, under this provision, the cost of construction of an electric generating facility cannot be included in the rates charged until it is, by its definition, used and useful, that is, providing actual utility service. It thus maintains that Duquesne cannot amortize cancellation costs since the four plants will never provide service.

By contrast, it is the position of the PUC that, under Section 1315, Duquesne should be permitted to amortize its share of the cancelled plant costs over a ten year period because this provision does not prohibit the amortization of prudently incurred cancelled plant costs in customer rates. The PUC alleges it allowed Duquesne a recovery of its investment in the cancelled plants but that Duquesne received no return on its investment nor any portion of the cancelled plant costs. Section 1315, it asserts, merely codified the long standing practice of disallowing the inclusion of construction work in progress (CWIP) in the rate base.

In *Bell Telephone Co. v. Pennsylvania Public Utility Commission*, 47 Pa. Commonwealth Ct. 614, 408 A.2d 917 (1979), we stated that the Code

> authorizes utilities to seek a just and reasonable return on the fair value of property used and useful

> in the public service. What constitutes used and useful utility property is committed to the *discretion* of the Commission. If the Commission reasonably finds that a particular class of property is not used or useful in serving the public, it may exclude the value of that property from the *rate base* and thus disallow the utility's return on that property. (Emphasis added.)

47 Pa. Commonwealth Ct. at 629, 408 A.2d at 924. Furthermore, "[i]n the area of adjustments to rate base, the [PUC] has wide discretion." *UGI Corp. v. Pennsylvania Public Utility Commission*, 49 Pa. Commonwealth Ct. 69, 79, 410 A.2d 923, 929 (1980). In our view, the PUC has correctly applied Section 1315 and, therefore, we agree with its interpretation and analysis of this provision.

According to the rules of statutory construction, the title and preamble of a statute may be considered in the construction of that statute. Section 1924 of the Statutory Construction Act, 1 Pa.C.S. § 1924. The limiting title and preamble of Act 335, adding Section 1315, described itself as one "providing a limitation on the consideration of costs in the *rate base* for *electric* public utilities." (Emphasis added.) This phrase relates exclusively to a consideration of *rate base* and not a legislative intent to exclude the costs of cancelled facilities from the revenue or expense factors of ratemaking. This interpretation, moreover, may be inferred from the provisions of the Code where "used and useful" relates *only* to rate base inclusions and not at all to expense allowances. For instance, Section 1307 of the Code, 66 Pa.C.S. § 1307, provides that a public utility should establish rates which provide a just and reasonable return on the fair value of its property "used and useful" in

the public service; and, Section 1310 of the Code, 66 Pa.C.S. § 1310, authorizes the PUC to investigate rates which produce a possible return "in excess of a fair return . . . upon property used and useful in its public service." The Code nowhere employs this phrase regarding the allowance of items of expense. Case law also indicates that the "used and useful" concept is uniformly employed in considering only rate base questions. *See, for example, Philadelphia Electric Co. v. Pennsylvania Public Utility Commission*, 61 Pa. Commonwealth Ct. 325, 433 A.2d 620 (1981); *Bell Telephone Co.; Keystone Water Co., White Deer District v. Pennsylvania Public Utility Commission*, 477 Pa. 594, 385 A.2d 946 (1978).

Properly interpreted, the key language upon which OCA relies, that is, "nor otherwise included in the rates charged", serves to prohibit the inclusion of CWIP in rate base and safeguard against alternative ratemaking methods which seek to accomplish the same or a similar result. We believe that when the legislature added Section 1315, it codified the already existing PUC policy regarding the exclusion of CWIP in the rate base. We, in fact, have held that CWIP is not used and useful property and thus not entitled to a return until actually in service. *Bell Telephone Co.*

Act 335, adding Section 1315, was adopted following a controversy which involved the cost of constructing Philadelphia Electric Company's nuclear generating system on the Schuylkill River. It had requested the inclusion of $500,000,000.00 of the construction costs of the plant in rate base and proposed the removal of all restraints associated with the PUC policy of limited inclusion of CWIP in rate base. The PUC, however, rejected this claim and proposal as a matter of policy and affirmed its statutory authority to permit these

costs in rate base. *Pennsylvania Public Utility Commission v. Philadelphia Electric Company*, R-811626, May 21, 1982, 56 Pa. PUC (1982). In March, 1982 the Pennsylvania Senate passed a resolution expressing a viewpoint that the Code did not permit the inclusion of CWIP in rate base.[3] Act 335, adding Section 1315, was adopted on December 30, 1982, effective immediately, and was obviously meant to settle the issue regarding CWIP in accordance with the resolution.

In our view, the words and meaning of Section 1315 are not entirely clear. Under Section 1921(c) of the Statutory Construction Act, where the meaning of a statute is not explicit, the intention of the legislature may be ascertained by considering:

> (1) The occasion and necessity for the statute.
>
> (2) The circumstances under which it was enacted.
>
> (3) The mischief to be remedied.
>
> (4) The object to be attained.
>
> (5) The former law, if any, including other statutes upon the same or similar subjects.
>
> (6) The consequences of a particular interpretation.
>
> (7) The contemporaneous legislative history.
>
> (8) Legislative and administrative interpretations of the same statute.

1 Pa.C.S. § 1921(c). The legislature enacted the Act specifically to counter Philadelphia Electric Company's controversial request to include CWIP in rate base before the facilities actually served the public. By doing so, the legislature endorsed the longstanding PUC policy regarding treatment accorded CWIP rate base claims thereby codifying the exclusion of rate base in

[3]The resolution was implemented by the introduction of Senate Bill No. 1366, Session of 1982.

the cost of a facility before it has been completed or has begun providing service to the public.

We believe the PUC properly permitted the inclusion of the cost of the cancelled nuclear plants and, therefore, affirm its order.

1364 C.D. 1984

The OCA appeals an order of the PUC which permitted inclusion of the costs of four cancelled nuclear units and allowance of land held for future use in rate base by Penn Power. The PUC order also permitted normalization of tax benefits for state income tax purposes.

In July, 1983, Penn Power filed tariff revisions in order to increase annual revenues by $19,890,200.00. This request included additional return revenues resulting from inclusion of $842,074.00 in rate base of land held for future use, the amortization over ten years of Penn Power's $9,569,665 investment in four cancelled nuclear plants, and normalization of tax benefits associated with effects of depreciation in application to state income taxes. On April 11, 1984, the PUC adopted Penn Power's proposals for ratemaking purposes and this appeal followed.

Because we have resolved the issue regarding the amortization of Penn Power's investment in the nuclear plants, we need not further address it.

The OCA asserts that the PUC violated Section 1315 when it permitted an allowance of land held for future use in rate base because it provided a return thereon to Penn Power. This claim, the OCA maintains, involved electric utility facilities none of which could be deemed "used and useful" as contemplated by Section 1315. We disagree.

We reiterate that Section 1315 contemplates disallowing the inclusion of CWIP in rate base and further that the Code and decisional law uniformly apply "used and useful" only to rate base questions.

The OCA next contends that normalization of the tax benefits associated with state income taxes violates the "actual taxes paid" doctrine. The case of *Barasch, Consumer Advocate of Pennsylvania v. Pennsylvania Public Utility Commission and Pennsylvania Power Company*, — Pa. —, 491 A.2d 94 (1985), supports the OCA and we, therefore, reverse on the normalization issue.

PALLADINO, J., dissents.

No. 553 C.D. 1983

ORDER

Now, June 13, 1985, the order of the Pennsylvania Public Utility Commission, entered January 28, 1983, and April 18, 1983, at No. R-821945, is affirmed.

No. 1364 C.D. 1984

ORDER

NOW, June 13, 1985, the order of the Pennsylvania Public Utility Commission, entered April 11, 1984, at No. R-832409, regarding the inclusion of costs of cancelled nuclear plants and land held for future use in rate base, is affirmed and the order regarding normalization of actual state income tax expenses is reversed.

CRUMLISH, Jr., President Judge, concurring.

I agree with the able and articulate reasoning of the majority, but include an additional comment.

If we had concluded that Section 1315 extended beyond rate base and encompassed all components of rate structure, I would still have held it inapplicable to

the costs of these cancelled nuclear plants. This statute is only intended to prevent the inclusion in rates of construction work *in progress*. When construction is cancelled, a fortiori it does not progress. Section 1315's proscriptive effect attaches "*until such time* as the facility is used and useful. . . ." (Emphasis added.) The General Assembly's language unmistakably connotes a concept of delayed recoupment, not of total forfeiture, as would result if this provision barred recovery of costs associated with plants never to be completed.

Serious constitutional problems would be raised by precluding a utility from ever regaining monies prudently invested for the public benefit. Also, as alluded to by the majority, Section 1315 was enacted in response to a specific instance where a utility sought to charge rates for the costs of *ongoing* construction on a facility *scheduled for future completion*.[1] I would therefore construe Section 1315 as a provision concerned solely with construction work in progress.

COLINS, Judge, dissenting.

I must disagree with the conclusion by the majority in *Cohen v. Pennsylvania Public Utility Commission*, — Pa. Commonwealth Ct. —, 494 A.2d 58 (1985), that losses incurred by Duquesne as a result of expenditures on now-abandoned nuclear power plants should be borne by the consumer. Section 1315 of the Public Utility Code[2] clearly disallows the inclusion of the costs of construction of a facility in the rate base until it is used and useful, a practice already followed by the Public Utility Commission (PUC). But Section 1315 did not merely reiterate an existing PUC practice, but rather

[1] *See* majority opinion, at 62.
[2] 66 Pa.C.S. § 1315.

went on to state that these costs shall not be "otherwise included" in the rates charged until the facility is used and useful. Obviously, the legislature intended that the costs of CWIP's should not be included anywhere in the rates charged until the facility is being used.

Section 1921(a) of the Statutory Construction Act[3] states that "[e]very statute shall be construed, if possible, to give effect to all its provisions." Section 1921(b)[4] directs that "[w]hen the words of a statute are clear and free from all ambiguity, the letter of it is not to be disregarded under the pretext of pursuing its spirit." The interpretation given Section 1315 by the majority ignores a directive in the statute that "the cost of construction . . . of a facility undertaken by a public utility producing, generating, transmitting, distributing or furnishing electricity shall not be made a part of the rate base *nor otherwise included in the rates charged by the electric utility* until such times as the facility is used and useful in service to the public." (Emphasis added.)

The majority has misinterpreted the statute by ignoring the key phrase "nor otherwise included in the rates charged." The entire statute as it stands is not ambiguous. Any costs incurred in constructing a new facility by a public utility furnishing electricity cannot be included anywhere in its rates until that facility is actually providing utility service to its customers. If the legislature merely wished to codify a practice already utilized by the PUC in its rate computation, it would have simply disallowed the inclusion of these costs in the rate base. The legislature clearly intended that the costs of facilities which are not actually providing

[3] 1 Pa.C.S. § 1921(a).
[4] 1 Pa.C.S. § 1921(b).

service should not be borne by consumers anywhere in the rates paid until they are producing electricity.

Therefore, the decision of the PUC should be reversed.

MacPHAIL and PALLADINO, JJ., join.

APPENDIX C

Order of the Pennsylvania Public Utility Commission (Duquesne Light Co.)

Pennsylvania Public Utility Commission
v.
Duquesne Light Company

Intervenors: United States Steel Corporation, Office of Consumer Advocate, Pennsylvania Alliance for Jobs and Energy, Equitable Life Assurance Society of the United States, Joseph Horne Company, Kaufmann's, Gimbels, Gulf and Western Manufacturing Company, Armco, Inc., and Hospital Council of Western Pennsylvania

R-821945 et al.
January 27, 1983

APPLICATION *for authority to increase electric rates; granted as modified; income tax allowance reduced by hypothetical interest associated with accumulated deferred tax credits.*

By the COMMISSION:

Opinion and Order

I. *Introduction*

On April 30, 1982, Duquesne Light Company (respondent or Duquesne) filed, with the commission, Tariff Electric-Pa. PUC No. 15. The proposed tariff contained changes in rates, rules, and regulations designed to produce an increase in annual Pennsylvania jurisdictional electric revenues of approximately $165,013,000 based upon a future test-year level of operations for the twelve months ending December 31, 1982.

This proposed tariff was suspended by operation of law until January 29, 1983. By order entered June 4, 1982, we instituted this investigation at R-821945. Nine formal complaints were filed against the proposed rate increase and these were consolidated with our investigation for purposes of hearing, briefing, and disposition.[1]

[1]Four of the complaints were filed by commercial customers which are owners of buildings in downtown Pittsburgh, and are referred to herein as "commercial complainants." These are the Equitable Life Assurance Society of the United States, Joseph Horne Company, Kaufmann's and Gimbels.

The Hospital Council of Western Pennsylvania was granted intervenor status.

Twenty-four days of hearings were held in Pittsburgh and Harrisburg before Administrative Law Judge Joseph J. Klovekorn (ALJ). Duquesne presented twenty-three witnesses. The commission trial staff (staff) presented four witnesses as did the Office of Consumer Advocate (OCA). The commercial complainants and United States Steel Corporation (USS) each presented a witness in the area of rate structure.

Main briefs have been filed by Duquesne, staff, OCA, commercial complainants, USS, Armco, Gulf and Western, and the Hospital Council. Reply briefs were filed by all parties except USS and the Hospital Council.

The ALJ's recommended decision was issued on December 10, 1982. Exceptions were filed on or before December 20, 1982, by Duquesne, staff, OCA, commercial complainants, Armco, and the Pennsylvania Alliance for Jobs and Energy (PAJE). Replies to exceptions were filed on or before December 27, 1982, by Duquesne, staff, OCA, commercial complainants, and USS.

In addition to accomplishing disposition of this proceeding, this opinion and order completes the disposition of the respondent's petition regarding normalization of federal income taxes under the accelerated cost recovery system and also grants amortization of the respondent's cancellation costs arising from cancelled Central Area Power Coordination Group (CAPCO), construction which was the subject of investigation in the proceeding at I-79070315.

II. *Rate Base*

A. *Fair Value*

The respondent presented only original cost measures of value in this proceeding. Consequently, we shall adopt as the fair value of the respondent's rate base, the original cost measure of value as it shall be hereinafter determined.

B. *Electric Plant in Service*

Duquesne's claimed undepreciated original cost for electric plant in service on a *total company basis* as of the end of the future test year or December 31, 1982, is $2,246,044,570. This is based upon the reclassification of the plant accounts, effective December 31, 1936, as approved by the commission's orders of January 7, 1946, and February 9, 1948, at E.O.C. 10. Beginning January 1, 1938, the methods, procedures, and records for all property additions and retirements have been maintained in a manner compatible with the requirements of the basic plan approved by the commission. The company's continuing property records have also been maintained since that time in accordance with the approved CPR system. The Federal Energy Regulatory Commission (FERC) and the commission staff have periodically audited Duquesne's continuing records and related construction work order system and inspected its physical plant to ensure compliance.

The company's original cost measure of value contained in the original filing was predicated on the company's 1982 construction budget. During the course of the proceeding, numerous revisions, consisting of construction additions and deletions, changed in-service dates, revised construction costs, were made in the con-

struction programs reflected in the company's 1982 construction budget. Updated exhibits were filed to reflect these revisions.

Duquesne's claim is uncontested. We approve the claim.

C. *Depreciation Reserve*

Duquesne's claim for accrued depreciation (calculated reserve) applicable to its original cost—electric plant in service is $493,030,725, on a *total company basis*. In the last four Duquesne proceedings, we have approved Duquesne's estimated average service lives and survivor curves, and methodologies with respect to accrued depreciation for the transmission, distribution, and general plant accounts. In this proceeding Duquesne again prepared a life span analysis for all of its production plant, by unit. For each plant account, these exhibits set forth the original cost dollars, the probable retirement year of each unit, the estimated interim survivor curves, and the statistical support for each interim survivor curve. The depreciation calculations relating to production for each station are presented by plant account showing the original cost of the surviving plant by year of installation, the average life of the plant installed in each year, the annual accrual amount, the average remaining life expectancy, and the calculated reserve related to the original cost of each vintage.

The ALJ concluded that Duquesne's claim for accrued depreciation was supported by the uncontested evidence and recommended that it be accepted in this proceeding. We approve the claim.

D. *Additions to Rate Base*

1. *Property Held for Future Use and Other Items*

Duquesne has claimed $552,853, on a *total company basis*, for plant held for future use. This property consists of land with estimated in-service dates on or before 1988. No party has contested this claim. We find that the claim is reasonable and accordingly, it is allowed.

Duquesne has also claimed $61,482 as the undepreciated original cost of the used and useful plant of the Monongahela Light and Power Company. The associated depreciation reserve is $27,405. No party has contested this claim. We find the claim and the associated accumulated reserve to be reasonable and accordingly it is approved.

Additionally, Duquesne has claimed $355,000 as the undepreciated additional cost of the borough of Aspinwall plant, with an associated accumulated depreciation reserve of $275,125. No party has contested the claim and finding it otherwise reasonable, it is approved.

2. *Construction Work in Progress*

Duquesne's claim for electric plant in service reflects investment in plant which it expects to be in service at December 31, 1982. Additionally, it has claimed inclusion of construction work in progress (CWIP) with regard to certain nonrevenue-producing, regulatorily mandated projects, such as environmental control; and Nuclear Regulatory Commission (NRC) mandated projects. Duquesne's claim of $70,769,052, construction work in progress, on a *total company basis* is comprised of the following:

Construction Work in Progress (Net of Associated Retirements)	*Original Cost*	*Calculated Accrued Depreciation*
Environmental Control Projects	$52,479,898	$ 762,375
NRC Mandated	18,289,154	288,204
Claim	$70,769,052	$1,050,579

The company states that its claim reflects the estimated expenditures to complete the projects, all of which are expected to be in service during 1983, the year in which the rates to be set in this proceeding will be in effect. This claim, it urges, is consistent with allowances in other proceedings; citing Pennsylvania Pub. Utility Commission v Pennsylvania Power Co. R.I.D. 243, Jan. 27, 1977; Pennsylvania Pub. Utility Commission v. Dauphin Consol. Water Co. R-78050616, April 5, 1979; Pennsylvania Pub. Utility Commission v Philadelphia Electric Co. R-811626, May 21, 1982. These expenditures, it claims, are necessary for Duquesne to comply with environmental air and water pollution standards and NRC mandated requirements, in order to retain the existing capacity of generating stations already in service.

While not contesting the accuracy of the company's claim, the OCA opposes inclusion in rate base of any post-test-year expenditures. In support of its position, OCA cites our opinion and order in Pennsylvania Pub. Utility Commission v Penn Power, R-811510, Jan. 22, 1982.

The ALJ recommended approval of the respondent's claim. The OCA has excepted. We shall allow the claim based upon our decision in Pennsylvania Pub. Utility Commission v Philadelphia Electric Co. R-811626, May 21, 1982, wherein we distinguished a factual situation on almost all fours with the one present here, from that present in the Penn Power case. The essential feature of the claim here, which brings to within our policy of permitting the inclusion of pollution control and NRC mandated construction work in progress in rate base, is that the claim is limited to projects which will be in service within one year after the end of the future test year.

E. *Cash Working Capital*

Duquesne has submitted a cash working capital claim of $54,660,529, on a *total company basis*, as set forth below:

SUMMARY OF WORKING CAPITAL CLAIM

Operation and Maintenance Expense		$14,829,313
Prepayments:		
Prepaid Insurance	$1,477,277	
Prepaid Taxes—Real Estate	180,691	
Prepaid Federal Use Taxes on Highway Motor Vehicles	8,826	
Prepaid PUC Assessment	620,143	
Prepaid West Virginia Franchise Tax	513	
Prepaid Excise Tax	25,467	2,312,917
Deferred Rental under Nuclear Lease		20,596,196
Deferred Quarto Coal Cost		16,922,103
Total Cash Working Capital Requirement		$54,660,529

The staff proposes numerous adjustments to the company's claim. The staffs proposed cash working capital allowance is $13,450,086. The OCA also proposes numerous adjustments and an allowance of approximately $10 million. We will address each area of contention individually.

1. *Operation and Maintenance Expense—Lead-lag Study*

Duquesne's cash working capital claim associated with operation and maintenance expenses is based on a lead-lag study which uses 38.3 days for the average lag in the receipt of revenues and 24.5 days for the average lag in the payment of operating expenses.

The staff witness stated that the company's 38.3-day revenue lag includes a two-day allowance for processing and bank collection after receipt of payment, while, on the other hand, the 24.5-day expense lag claimed by the company includes only the period between the date goods and services are delivered or performed, and the

date of the check or disbursement voucher, no allowance being made for a disbursement float allegedly arising from mailing lag and bank processing.

The staff argues that if the lead-lag study is to include an allowance for disbursement float on the revenue side, it should also include an allowance for disbursement float on the expense side. The addition of a two-day expense lag to account for disbursement float would, according to the staff witness, decrease the cash working capital claim by $2.7 million.

The OCA would also reduce this claim by $2.7 million on the basis that this disbursement float amounts to the alternative equivalent of a claim for compensating bank balances.

Duquesne argues that the staff's adjustment erroneously assumed a two-day lag. It also states that the staff's proposed adjustment would recognize the same dollars which Duquesne has recognized by not claiming a compensating bank balance requirement, as the alternative to paying fees for banking services.

According to Duquesne's treasurer, R. G. Males:

"Checks are dated, entered in the cash book, and mailed the same day. The value of the checks mailed to the vendor and not yet presented for payment at the bank is disbursement float. A recent one-month analysis of cash disbursement indicates that 62.1 per cent of the total dollars expended during the month were processed through the bank account the same day entries were made to the cash book of the company. This is primarily attributable to sending large payments by bank wires. Bank wires are charged to the company's bank account on the same day the payment is sent and reduce both the bank ledger balance and collected bank

balance in the bank account. The remainder of the cash disbursements is disbursement float. For the month analyzed, January, 1982, $1,918,000 was disbursement float. Of the total cash disbursements for the month 14.1 per cent of the dollars was one-day disbursement float, 8.3 per cent was two-day, 9.9 per cent was three-day, with 5.6 per cent being four-day float or longer. As stated in the response to interrogatories of the consumer advocate, Set No. II, Item No. 2.20a last paragraph, the amount of the disbursement float is approximately equal to the amount of compensating balances required by the bank in 'payment' for demand deposit services. The company has made no claim for these required compensating balances. This is discussed in Duquesne Exh II, Item II-A-15, p. 2 of 2 and Item II-A-16e. The amount of the required compensating balances for demand deposit services is stated in Duquesne Exh II-A-16, p. 5, which is a portion of a copy of a letter from Roger N. Stanier, vice president of Mellon Bank. Should it be necessary to include the disbursement float in the calculation of the cash working capital expense lag days, it would then also be appropriate to include the amount of the disbursement float as a compensating balance requirement to be included in the cash working capital needs of the company."

It would appear from this record, therefore, that there is not a two-day lag, rather over 62 per cent of the total dollars expended during the month are processed the same day and have no lag. Duquesne states that the disbursement float which does exist is used to compensate the Mellon Bank for deposit and disbursement activity services. Such bank services normally require a fee or may take the form of a compensating balance requirement and such a claim has not been made here.

The record shows that the Mellon Bank would require some $1,980,000 in compensating balances for the deposit and disbursement activity services which it provided at the 1981 level.

The ALJ recommended that the proposed adjustment be rejected for two principal reasons: *First;* there is no support for the assumption that because there is a two-day revenue lag for processing and bank collection, there is a similar lag on the expense side. *Second;* the proposed adjustment fails to recognize that the disbursement float that does exist eliminates the need for a compensating balance requirement.

Both the staff and the OCA except. The proposed adjustments are rejected and the exceptions are denied. We have previously recognized that it is appropriate to offset disbursal float against compensating balance requirements (Pennsylvania Pub. Utility Commission v Pennsylvania Power Co. R-815510, Jan. 22, 1982). Here the waiver of a compensating balance claim constitutes the same result.

2. *Expense Payment Lag for Net Energy Clause Expenses*

Office of Consumer Advocate witness, Henkes, proposed reducing the company's cash working capital claim by $1,759,000 to reflect the expense lag associated with net energy clause energy expenses. The ALJ recommended that this adjustment be rejected: *First,* on the basis that Duquesne includes in its calculation, dollars associated with demand charges which Duquesne is not permitted to collect through its net energy clause and, therefore, to the extent those costs are in excess of the amount in base rates; dollars which it never recovers from its customers. *Second;* on the basis that the purchased power dollars (sales) are a net amount

and reflect sales of power by Duquesne to other companies, which at some subsequent point in time pay Duquesne for this power either in cash or in equivalent power. These dollars are reflected in the net energy clause as a credit to the customer when the power is delivered, not when they are actually paid. The OCA has excepted. The exception is denied. We conclude that the proposed adjustments are inappropriate for the reasons proffered by the ALJ.

3. *Prepayments*

Duquesne's claim with respect to prepayments of $22,312,917 is calculated on the basis of a 13-month average balance and is detailed in Duquesne Exh No. III, Item No. III-A-14. The claim is uncontested. The ALJ recommends its allowance. We find the claim reasonable and accordingly it is approved.

4. *Deferred Rentals under Nuclear Lease*

The company's claim of $20,596,196 for deferred rental under its nuclear fuel lease includes (i) $11,691,099 related to fuel presently in the reactor, (ii) $5,848,344 associated with the next reload, the fabrication of which will be completed before the rates in this proceeding will be in effect, and (iii) $3,056,753 for nuclear fuel still in process. The ALJ recommended approval of the first two items and disapproved of the third item.

The staff urges that that portion of deferred rental under its nuclear lease associated rental under its nuclear lease associated with nuclear fuel still in process (Items ii and iii above) be excluded from cash working capital allowance. It, therefore, proposed reducing the company's claim by $8,905,097. The OCA proposed a similar adjustment.

The issue of rate base treatment for nuclear fuel in process was recently considered in our opinion and order in Pennsylvania Pub. Utility Commission v Philadelphia Electric Co. R-811626, May 21, 1982. There we approved a claim for the company's investment in nuclear fuel in process. The company relies on that opinion and order to support its present claim.

There was no opposition to the inclusion in cash working capital of the $11,691,099 in rentals related to the fuel currently in the reactor. The ALJ recommended approval of this portion of the claim. No party excepted. We find this claim appropriate and accordingly, it is approved.

The objections to inclusion of the $5,848,344 associated with the next reload seem minor. Staff notes that this fuel will not be delivered until February, 1983, "well beyond the end of the 1982 test year." The OCA argues that there is no assurance that this fuel load will occur as currently scheduled. We know, however, that Beaver Valley will require a reload sometime shortly after these rates go into effect. Further, the delivery date is only a matter of some weeks past the end of the test year. This amount shall be allowed. Accordingly, the exceptions of the staff and OCA are denied.

With respect to the remaining $3,056,753, representing rentals on fuel in process, the ALJ recommended disallowance based upon the absence of the special circumstances which we found present in our opinion and order in Pennsylvania Pub. Utility Commission v Philadelphia Electric Co. R-811626, May 21, 1982. We stated there that:

"*Based upon the particular circumstances of this case and our determination that Limerick Unit No. 1 is in the public*

interest and is to be completed in the near future, we are of the conviction that recovery of the investment in nuclear fuel in process, other than that associated with Limerick Unit No. 2, is in the best interest of both the ratepayers and the company. We find merit in PECO's argument that a guaranteed fuel supply and avoidance of spot market purchases benefits both current and future ratepayers." (Emphasis added.)

We agree with the ALJ that those special circumstances are not present here. We conclude that the company's claim for deferred rentals for the remaining nuclear fuel in process should not be allowed for the reasons which we stated in our opinion and order in Pennsylvania Pub. Utility Commission v Pennsylvania Power Co. R-811510, Jan. 22, 1982, which was that this expense is most analogous to deferred energy costs, and that our long-standing policy is to allow a return on "used and useful" property but not on operating expenses. The company's exception is, accordingly, denied. As an alternative to inclusion in rate base, we shall permit, as suggested by the OCA, the company to accrue allowance for funds used during construction (AFUDC) on the disallowed sum of $3,056,753, in the manner and for the period set forth in the pertinent ordering paragraph.

5. *Accumulated Interest and Preferred Dividends Offset*

Although recognizing that in its rate proceeding, at R-80011069, we offset its cash working capital claim by an amount equal to its accumulated debt interest and preferred and preference stock dividends, Duquesne did not make such an adjustment here. The adjustment proposed by the staff for these items totals $12,622,000. The OCA proposed a similar adjustment although different in amount from the staff ($12.8 million).

Duquesne states that there is no actual basis for such an adjustment. It asserts that the basis for a cash working capital adjustment for accumulated interest expense and accumulated preferred stock dividends should be no different than any other aspect of a lead-lag study. That is, such an offset, is only appropriate where the recovery of interest and dividends from ratepayers actually leads the disbursement of such interest and dividends to the investors.

Duquesne then states that the evidence in this record shows that, rather than the interest expense and preferred stock dividends being collected by the company from ratepayers prior to disbursement to Duquesne's investors, interest expense and preferred stock dividends are, in fact, paid by Duquesne to the company's investors well in advance of any payments received from Duquesne's ratepayers. In other words, Duquesne claims that receipt of the payments from ratepayers lag the actual cash payments to company's investors, a lag for which, Duquesne says, it has never sought compensation.

Interestingly, we note that Duquesne's witness Mr. Ellenberger acknowledged that in our opinion and order at R-80011069, we rejected this identical argument. Nonetheless, Duquesne pursues this matter yet again, citing a decision of the supreme court of the state of Rhode Island, which reversed a similar adjustment by the Rhode Island commission, on the basis that accumulated interest are investor-supplied funds, urging us to follow that decision. We are unpersuaded that such is the law in this commonwealth. This issue has been litigated by various utilities since an adjustment was first made by the commission in 1978. To date we

have made such an adjustment in at least 18 proceedings[2] and we have consistently been affirmed by the commonwealth court.[3] The ALJ recommends the adoption of an adjustment which was recalculated based upon his adopted rate base.

The respondent has excepted. The exception is denied and we will reduce the cash working capital claim, by $12,674,000, based upon our adopted rate base, which amount is identical to that calculated by the ALJ. Because of this identity of result, no commission adjustment to the ALJ's adopted rate base appears in Table II [omitted herein].

[2]Pennsylvania Pub. Utility Commission v Philadelphia Electric Co. R-811626, May 21, 1982; Pennsylvania Pub. Utility Commission v Pennsylvania Electric Co. R-811510, Jan. 22, 1982; Pennsylvania Pub. Utility Commission v Philadelphia Electric Co. R-80061225, April 24, 1981; Pennsylvania Pub. Utility Commission v Pennsylvania Gas & Water Co. R-80071235, April 24, 1981; Pennsylvania Pub. Utility Commission v. Duquesne Light Co. (1981) 54 Pa PUC 695, 43 PUR4th 27; Pennsylvania Pub. Utility Commission v West Penn Power Co. (1981) 54 Pa PUC 602; Pennsylvania Pub. Utility Commission v Pennsylvania Power & Light Co. (1981) 54 Pa PUC 645; Pennsylvania Pub. Utility Commission v National Fuel Gas Distribution Corp. (1980) 54 Pa PUC 401, 40 PUR4th 101; Pennsylvania Pub. Utility Commission v Carnegie Gas Co. R-79100981, July 25, 1980; Pennsylvania Pub. Utility Commission v Philadelphia Suburban Water Co. R-78040824, Feb. 1, 1980; Pennsylvania Pub. Utility Commission v West Penn Power Co. (1979) 53 Pa PUC 410, 32 PUR4th 245; Pennsylvania Pub. Utilitv Commission v Pennsylvania Electric Co. (1979) 53 Pa PUC 203; Pennsylvania Pub. Utility Commission v Metropolitan Edison Co. (1979) 53 Pa PUC 225, 28 PUR4th 555; Pennsylvania Pub. Utility Commission v Pennsylvania Power Co. (1978) 52 Pa PUC 457, 27 PUR4th 426; Pennsylvania Pub. Utility Commission v Philadelphia Electric Co. (1978) 52 Pa PUC 772, 31 PUR4th 15; Pennsylvania Pub. Utility Commission v Peoples Nat. Gas Co. (1978) 52 Pa PUC 616, 28 PUR4th 180; Pennsylvania Pub. Utility Commission v Pennsylvania Electric Co. (1978) 51 Pa PUC 649; Pennsylvania Pub. Utility Commission v UGI Corp. (1978) 52 Pa Puc 383.

[3]Philadelphia Electric Co. v Pennsylvania Pub. Utility Commission (1981) 62 Pa Cmwlth 325, 433 A2d 620; UGI Corp. v Pennsylvania Pub. Utility Commission (1980) 49 Pa Cmwlth 69, 410 A2d 923; Peoples Nat. Gas Co. v Pennsylvania Pub. Utility Commission (1980) 52 Pa Cmwlth 201, 415 A2d 937; Penn Electric Co. v Pennsylvania Pub. Utility Commission (1980) 53 Pa Cmwlth 186, 417 A2d 819.

6. *Deferred Quarto Coal Costs*

A portion of the coal requirements for the Mansfield units, which are owned in part, by Duquesne, is supplied from the Quarto mine. On December 11, 1980, we instituted an investigation at I-80120343 regarding the reasonableness of the cost of coal from this mine. On January 12, 1981, we entered an interim order providing:

"[t]hat for purposes of calculating the current net energy clauses of Duquesne Light Company and Pennsylvania Power Company, the companies shall limit pricing of Quarto coal to market prices determined by the same methodology used prior to removing the mines from development; such limitation shall commence upon entry of the order and shall remain in effect until that instant investigation is concluded, or until otherwise ordered by the commission.

"That Duquesne Light Company and Pennsylvania Power Company shall defer collection of the cost of the Quarto coal that may be uncovered as a result of Ordering Par No. 1, pending the termination of the instant investigation."

Duquesne's cash working capital claim includes $16,922,103 for deferred Quarto coal costs. The company argues that these coal costs were reasonably incurred and its inability during the continuance of the investigation to pass on to its customers the full costs incurred by it for such coal does not change this fact. Duquesne then argues that the carrying costs created by the deferrals are busines costs incurred by it, no different than other investor-supplied expenditures.

The staff and the OCA oppose this claim. They argue that by including those costs in its cash working capital claim, Duquesne is requesting a current return on costs

that are now under investigation and may be found to be excessive and unreasonable.

The ALJ recommends disallowance of this claim, at least pending completion of the investigation.

The respondent has excepted. We adopt the proposed adjustment and deny Duquesne's exception. Our interim order of January 12, 1981, effectively questioned the reasonableness of those costs which were required to be deferred. It would be inconsistent for us to permit a return on such deferred costs, by permitting their inclusion in rate base.

7. *Customer Deposits*

The OCA proposes a $1.7 million deduction to reflect the elimination of customer deposits from rate base, and proposes that interest on customer deposits be included as an above-the-line expense. Duquesne opposes the adjustment as a change without substance, and urges that the adjustment be rejected, as was done in the proceeding at R-811470. In that proceeding, the adjustment proposed by the Pennsylvania Alliance for Jobs and Energy was rejected, because of a failure to address the subject of the treatment to be accorded the associated interest expense. Here the OCA proposes a concomitant interest expense adjustment. The ALJ recommends adoption of the proposed adjustment. We agree that such an adjustment is appropriate, and Duquesne's exception is denied. It is well established investors should not be permitted to earn a return on funds which they do not supply. Conversely, the interest that Duquesne pays on such amount is a legitimate business expense for which it should be made whole. We shall, therefore, make the concomitant adjustment for interest expense.

F. *Other Working Capital*

1. *Materials and Supplies*

As shown in Duquesne Exh No. 1B, p. F-2, Duquesne's total working capital claim includes a materials and supplies (other than fuel) inventory claim of $29,123,728 based upon the 13-month average budgeted balance of the materials and supplies inventory. No party has contested this claim.

The company's materials and supplies working capital claim is consistent with the commission's tariff regulations which specifically request the monthly materials and supplies book balances for the thirteen months prior to the end of the test year. (52 Pa Code, § 53.53, item I-A-15.)

The ALJ includes [sic] that Duquesne's materials and supplies working capital claim of $29,123,728 is reasonable and recommends approval of its claim. We agree and approve the claim.

2. *Fuel inventory*

As shown in Duquesne Exh No. 1B, p. F-1, Duquesne's working capital claim includes a fuel on hand claim of $44,537,267 for coal and oil in inventory. This figure was based upon adjusted test-year conditions as to load distribution for assumed Beaver Valley Unit No. 1 operation under conditions comparable to a 63.6 per cent capacity factor and Shippingport shutdown all year. No party to the proceeding has submitted evidence contesting this claim.

The company's fuel inventory claim is consistent with the commission's regulations which specifically request the monthly fuel on hand balances (quantity and price) for the thirteen months prior to the end of

the test year (52 Pa Code, § 53.53, Item I-A-16). In previous proceedings we have allowed similar claims. See, e.g., Pennsylvania Pub. Utility Commission v Pennsylvania Power & Light Co. (1981) 54 Pa PUC 645; Pennsylvania Pub. Utility Commission v Duquesne Light Co. (1981) 54 Pa PUC 695, 43 PUR4th 27.

Duquesne's fuel on hand working capital claim of $44,537,267 is reasonable and it is approved.

G. *Conclusion*

Our adopted fair value rate base on a Pennsylvania jurisdictional basis, is $1,779,313,000.

We should note for the benefit of the reader that no party contested the company's proposed rate base reduction applicable to sales for resale under the jurisdiction of the Federal Energy Regulatory Commission. We approve that jurisdictional allocation without additional comment herein.

III. *Operating Revenues*

Duquesne estimated its test-year *total company*, operating revenues at present rates at $693,113,000, which includes a number of adjustments, most of which were uncontested. Additionally, the staff proposed one adjustment. These shall be addressed seriatim.

A. *Uncontested Adjustments*

Seven adjustments by Duquesne to its estimated operating revenues were uncontested by the parties. These were:

(1) A reduction of $33,310,000 to eliminate the state tax adjustment Rider 10 revenues;

(2) A reduction of $134,590,000 to eliminate the energy cost rate revenues;

(3) An increase of $3,796,000 to reflect the estimated additional revenues resulting from annualizing the increase in the number of customers during the test year;

(4) An increase of $1,266,000 to reflect the estimated additional revenues resulting from annualizing the increase in use per customer during the test year;

(5) An increase of $18,000 to reflect the estimated additional revenues resulting from annualization of late payment charges to reflect increases in number of customers and increases in usage per customer;

(6) An increase of $3,000 to reflect the estimated revenue from the residential conservation program for the test year. (Although this estimate was reduced to $1,785 in Duquesne Exh No. 313-4 the claim was not revised); and,

(7) An increase in miscellaneous service revenues of $93,000 to reflect the revenues expected to result from the proposed returned check and reconnection charges.

These uncontested adjustments and the amount thereof appearing to be reasonable are accepted.

B. *Sales to Crucible Steel*

Duquesne reduced test-year revenues by $18,649,916 to reflect the loss of sales associated with the shutdown of Crucible Steel's Midland plant which occurred during the future test year but which was unanticipated when the 1982 budget was prepared. The reduction of $18,649,916 is a net amount; that is, the annualized budget revenue for the Midland plant of $26,696,696, less the amount of $8,046,780 expected to be recovered under the demand ratchet provisions of Duquesne's tariff. This adjustment was based upon an estimated loss of 693,880,000 kilowatt-hours of sales, which in turn

was based upon annualized sales, predicated upon the then highest demand months of 1981.

The staff contested the Duquesne proposal with a proposed alternative adjustment of $15,814,395. The staff's proposed downward adjustment of $2,835,521 to Duquesne's proposed adjustment is accompanied by a concomitant adjustment (increase) in operating expenses of $933,739.

The difficulty encountered with regard to an adjustment for the closing of Crucible Steel's Midland plant, is that while the 1982 budgeted sales estimates contains a projected sales estimate of 4,430 million kilowatt-hours for the seven largest steel producers, it does not contain an individual figure for Crucible Steel's Midland plant. While the company's adjustment was based upon the highest three-month demand period of June to August, 1981, the staff's proposed adjustment was based upon the demands for the eight-month period of May to December, 1981.

In rebuttal the company, through its witness Dudt, attempted to bolster its proposed adjustment by pointing out that its 1982 sales estimate of 4,430 million kilowatt-hours for all seven steel producers, prepared in late September or October, 1981, is compatible with the February 12, 1981, estimate prepared by the industrial service department of 4,400 million kilowatt-hours, of which Crucible Steel sales at the Midland plant represented 775 million kilowatt-hours. Therefore, reasons Mr. Dudt, the 1982 budgeted sales estimate reasonably could have included as much as 780 million kilowatt-hours of sales for the Midland plant, as contrasted with Duquesne's proposed adjustment based upon 694 million kilowatt-hours of sales.

We are confronted with what is essentially a budget forecast of sales to the seven largest steel producers of 4,430 million kilowatt-hours, prepared by Data Resources, Inc., based upon "outputs" and peaks that are developed in the official load forecasts[4] prepared in September or October, 1981, and a similar estimate of 4,400 million kilowatt-hours prepared some months earlier, in February, 1981, based upon an unknown methodology. Based upon the similarity of results we are asked to accept that the ingredients are reasonably the same and that the 1982 budget estimate of sales includes 775 or 780 million kilowatt-hours of sales for the Crucible Steel Midland plant. We cannot accept this type of reasoning and the conclusion urged upon us by Duquesne.

The question posed by staff counsel at Tr. p. 169 was most pertinent. That question was: "Isn't the real question here, Mr. Maxwell, what was in the budget for Crucible Steel not what's a reasonable load for Crucible Steel?" However, it appears that we do not have an acceptable answer to the first portion of the question and must be satisfied with an answer to the second portion of the question. In examining Duquesne's adjustment methodology as contrasted with that of the staff, we find nothing to commend it over the staff's methodology, insofar as validity is concerned, and therefore, we conclude that Duquesne has failed to meet its burden of proof with regard to this adjustment.

Duquesne excepted to the ALJ's recommendation of the staff's proposed adjustment. Having concluded that Duquesne failed in its burden to establish that its adjustment was more appropriate, its exception is denied.

[4]This is an oversimplified description of an estimating process the description of which is contained in approximately 30 pages of text, tables, and diagrams in Exh 1, Item 1-B-6-8.

C. *General Public Utili[illegible] Revenues*

Duquesne adjusted future test-year revenues downward by $720,000 to eliminate revenues received by the company pursuant to the CAPCO basic operating agreement as an indirect participant in capacity and energy sales from Ontario Hydro to General Public Utilities (GPU). The company argues that it has no control over the GPU/Ontario Hydro agreement, which may be canceled at any time by mutual agreement of the parties, and therefore, it cannot be certain that it will actually receive such revenues.

The staff and the OCA oppose this adjustment. Staff argues that there is no evidence on this record that the contract with Ontario Hydro has been canceled or is about to be canceled. Moreover, no evidence exists in this record to support the view that GPU's purchased power requirement would be reduced in the near-term future. As of the close of this record, that contract is still in effect and producing revenues for Duquesne. The ALJ recommended that the staff's position be adopted and the company's claimed operating revenues be increased by $720,000 to account for the Ontario Hydro transaction.

Duquesne has not excepted, and failing to perceive any factual basis for Duquesne's proposed adjustment, it is rejected. Estimated operating revenues will be increased accordingly.

D. *St. Joe's Mineral Corporation Purchases and Sales*

Staff proposed an increase of $211,800 in operating revenues as a result of sales of power purchased from St. Joe Minerals Corporation, which is eventually sold to General Public Utilities through the CAPCO system.

Of the revenues of $35,300 per month projected by Duquesne approximately one-half are credited through the energy cost rate, leaving the annualized amount of $211,800 not presently reflected as revenues. Although Duquesne did not address this subject in its briefs, the apparent reason for not including the revenues in its estimates is the uncertainty of the continuation of the arrangement through 1983. The ALJ recommended adoption of the staff's proposed adjustment. Duquesne has not excepted. Finding the staff's proposed adjustment reasonable and appropriate, it is adopted. Revenue estimates will be accordingly adjusted.

E. *Deductions from Rate Base*

Accumulated Deferred Income Taxes

The respondent has proposed *a total company* deduction from rate base of $136,980,140 by reason of accumulated deferred income taxes. No party has questioned the appropriateness of this amount. The amount appearing reasonable, it is adopted as the proper deduction from rate base by reason of accumulated deferred income taxes.

IV. *Expenses*

Duquesne's estimated operating expenses, as of December 31, 1982, were adjusted to reflect annualization to the level of operations at December 31, 1982. Based upon such pro forma levels of operations, Duquesne's operating expense claim (excluding income taxes) is $472,632,000, which amount reflects the elimination of $125,361,000 of energy cost rate related expenses. The various individual adjustments are discussed seriatim.

A. *Operation and Maintenance*

1. *Wages, Pensions, and Employee Benefits*

Duquesne included in its pro forma level of operations, additional operations and maintenance expenses to: (1) annualize the effect of wage increases to various groups of employees (increases effective October 1, 1982, pursuant to the International Brotherhood of Electrical Workers [IBEW] contract and merit increases to non-union employees effective on the same date); (2) annualize the increase in pension and other employee benefits applicable to the salary and wage increases of October 1, 1982; and (3) to annualize charges by operators of jointly owned generating stations for increases in wages and fringe benefits for employees at each station.

After noting that Duquesne is increasing wages by 10.05 per cent in 1982, staff "suggests that some recognition should be given to the current economic climate with respect to wage increases by moderating the amount of the claimed wage increases for rate-making purposes." The ALJ rejected this suggestion emphasizing that a speculative wage adjustment was not included, but, rather, a known wage increase, effective October 1, 1982, pursuant to the respondent's contract with the International Brotherhood of Electrical Workers.

The staff excepted to the ALJ's conclusion and referred to a similar adjustment made by the Wisconsin Public Service Commission in a Wisconsin Electric Power rate case. Upon examination, we find that the Wisconsin commission held that the *projected 8.20 per cent wage increase* was unreasonable in light of the smaller wage settlements being negotiated by unregulated firms (*Electric Week*, November 29, 1982). Du-

quesne has replied by contending that this was the second year of the contract, which Duquesne would be required to break if the adjustment suggested by staff were made.

We concur with the ALJ's disposition of the adjustment proposed by the staff. Its proposed wage expense adjustment to reflect "current economic conditions" has not been supported by any record evidence. The staff has not presented specific evidence which would indicate that the subject wage increase is excessive.

2. *Rate Case Expense*

Duquesne's rate case expense claim in this proceeding is comprised of an amount related to the current proceeding and amounts related to prior proceedings before this commission. With respect to the expenses for the current proceeding, the respondent has claimed a "normalized" annual level of $600,000.[5] The respondent's prior proceeding claim of $151,328 is based on the unrecovered costs associated with RID 198 and RID 373 and the unrecovered amount associated with R-79010740, amortized over five years.

The staff contends that the respondent's claim is "grossly inflated" and "inconsistent" with prior commission decisions which establish clear commission policy in this area. The staff relies upon Pennsylvania Pub. Utility Commission v Pennsylvania Power Co. R-811510, pp. 21–23, Jan. 22, 1982, in arguing that the following commission policy on rate case expense has been established:

[5]As Duquesne notes in its main brief, it did not adjust operating and maintenance expenses in its final income statement to reflect a $100,000 increase from its original estimate of rate case expenses at Duquesne Exh No. 1B, Note 15, p. 111.

"First, the unrecovered portion of prior rate case expenses is to be amortized over ten years, after which that component ceases to be a factor in the rate-making process. Second, the normalized level of rate case expense is to be shared equally between ratepayers and stockholders. Third, the normalized level is determined on a case-by-case basis, although two years is typically used to develop the normalized amount."

Based upon these supposed guidelines, staff proposed a total rate case allowance for Duquesne amounting to a maximum of $176,264 calculated as follows:

(a) $26,264 to continue the ten-year amortization of prior rate case expenses established in Duquesne's recent rate case at R-80011069 for the unrecovered expenses associated with all prior rate cases; and,

(b) $150,000 based on a $600,000 rate case expense, normalized over two years and shared equally between ratepayers and stockholders.

The staff contends further, that the commission concluded in the opinion and order in R-80011069 that there was no unrecovered rate case expense associated with the settled rate case at R-7910740. Pennsylvania Pub. Utility Commission v Duquesne Light Co. (1981) 54 Pa PUC 695, 43 PUR4th at pp. 53, 54.

The OCA recommends a total rate case expense allowance of $271,450. Mr. Henkes, the OCA witness, (1) referred to the opinion and order at R-80011069 and did not recognized any amortization for the rate case expense incurred in the respondent's prior rate proceeding at R-79010740; (2) advocated a ten-year amortization of the unamortized rate case expense balances from prior proceedings; and, (3) reduced the $500,000 normalized

annual level of rate case expenses by $250,000 to reflect a 50/50 sharing of such expense between ratepayers and stockholders.

Duquesne contests the disallowance of its claimed unrecovered rate case expense from the 1979 proceeding (R-79010740), arguing that it is unfair and inconsistent with sound rate-making principle to disallow the claimed unrecovered rate case expenses merely because the case involved a settlement, especially when the staff had recommended therein the recovery of $498,853 over a five-year period. Therefore, Duquesne claims this amount in the current proceeding, as a portion of the unamortized rate case expense to be amortized over five years. Duquesne has claimed the amount of $542,153, for that proceeding, contending that this was the actual cost, rather than the cited staff figure, arguing that none of it will have been recovered as of the end of the future test year. This translates into a rate case expense claim of $108,430.60 ($542,153 ÷ 5) for the unrecovered costs associated with R-79010740.

Although acknowledging that in our opinion and order at R-80011069, we also directed that the unrecovered rate case expense balance be amortized over a ten-year period, the respondent's claim reflects a five-year amortization of the unrecovered balance.[6] Duquesne argues that this is a more equitable period, considering the fact that these expenses began to be incurred more than five years ago and that the commission has refused to include the unamortized amounts in its working capital, rate base claim.

[6]As of December 31, 1982, Duquesne claims an unamortized balance of $214,489, for the proceedings at RID 198 and RID 373. Our unamortized balance is calculated in footnote 7.

Finally, the respondent contests the 50/50 sharing of rate case expenses between the ratepayers and the stockholders. Duquesne submits that these expenses are a reasonable and legitimate cost of doing business and not a cost properly to be borne by investors. Duquesne also asserts that its current rate case claim of some $600,000 is reasonable and should be allowed.

The ALJ rejected the respondent's rate case expense claim of $651,328 and adopted staff's recommendation of a $176,264 allowance for rate case expenses in this proceeding. This total rate case expense allowance of $176,264 consists of $26,264 representing the continued ten-year amortization of past rate case expenses and $150,000 to reflect the normalized amount of current rate case expenses. In arriving at his recommendation, the ALJ found the arguments raised by Duquesne to be an insufficient basis upon which to depart from the treatment accorded to rate case expense in our previous decisions.

Duquesne excepts to the ALJ's recommendation. In its exceptions, the respondent again submits that the disallowance of any amount of rate case expense incurred in the proceeding at R-79010740, is grossly unfair and inconsistent with sound ratemaking principles. Furthermore, they argue that a ten-year amortization of prior rate case expense is an unreasonably long period. With respect to the current rate case expense and the ALJ's adoption of a two-year normalization period, the respondent contends that based upon rate increase filings in each of the last four years a more reasonable normalization period is one year. Finally, the respondent submits that Administrative Law Judge Mindlin's recommended decision at R-811819 (the Bell Telephone Company of Pennsylvania), dated August 6, 1982, cor-

rectly summarizes the fallacy of an equal sharing of rate case expenses between ratepayers and stockholders and his reasoning should be followed in this proceeding.

With regard to our conclusion, as expressed in our opinion and order in the proceeding at R-8001109, that there was no unamortized rate case expense arising from the proceedings at R-79010740, Duquesne did not seek revision of our conclusion in its petition for reconsideration and clarification filed therein on March 6, 1981. However, in essence, its claim here seeks reconsideration of that decision. While we might reject its claim here for untimeliness, we have considered the merits of its claim, and conclude again that our decision in our opinion and order in the proceedings at R-80011069 was correct, and we affirm our prior decision on this subject.

With regard to the amortization period of ten years, adopted in the proceeding at R-80011069, in this proceeding, Duquesne has requested reamortization of past rate case expense over a five-year period. We have reconsidered this matter and will grant its request. This will result in an allowance of $42,460 for amortization of past rate case expenses.[7]

With regard to current rate case expense we find the revised claim of $600,000 to be a reasonable level of expense. We have closely examined Duquesne's contentions with regard to the reasonableness of our past practice of adopting a 50/50 sharing of these costs between ratepayers and stockholders and being unpersuaded that it is either unreasonable or unwise we adhere to our recent practice of sharing the burden of these costs. With regard to the period to be adopted to

[7]Initial balance $262,640 – 23/120 of $262,640 or $50,340 = 212,300 ÷ 5 = $42,460.

determine a proper normalization allowance, Duquesne has argued, based upon recent proceedings, that a one-year period should be adopted. While we note that its rate increase applications have been filed on an almost annual basis, based upon recent developments with regard to inflation rates, the cost of money, and wage settlements, we conclude that two years is a reasonable expectation for the life of rates to be established herein. Consequently, we adopt a two-year period and will allow $150,000 as a reasonable normalized expense.

Our total allowance therefore is $192,460 which constitutes a disallowance of $458,868 of the amount claimed.

3. *Shippingport Expenses*

The Shippingport atomic power station was removed from service on October 1, 1982. By opinion and order adopted October 15, 1982, at P-820388, we approved Duquesne's petition to retire Shippingport.

Duquesne made two test-year adjustments to reflect the removal of Shippingport from service. The first adjustment reduced production operations and maintenance expenses by $2,839,000 to reflect the cessation of operation. No evidence was submitted by other parties contesting this adjustment and the ALJ adopted the proposed adjustment. We find the adjustment to be reasonable and adopt the ALJ's recommendation.

The second adjustment provides for the amortization over a ten-year period, of the unamortized balance of investment in Shippingport. The estimated undepreciated original cost of the unit will be $12,720,855. This balance, after further adjustments, including credits for accumulated deferred income taxes, will amount to

$4,728,160. Duquesne seeks to amortize the $4,728,160 over a ten-year period for an annual recovery of $472,816.

The staff and the OCA oppose this adjustment in part. The staff contends that Duquesne has included a $771,898 claim for the unrecovered depreciation associated with the periods prior to 1978, with the bulk of those unrecovered depreciation expenses ($687,000) relating to the period April, 1967, through June 1970. The staff argues that current ratepayers should not be burdened with depreciation expenses that could have been claimed more than ten years ago.

Duquesne argues that it has booked substantially greater dollars than it has been reimbursed by ratepayers, with the difference between book depreciation and reimbursed depreciation, during the 1969-77 period, being primarily due to the lapse of time between the test-year-end and the effective date of increased rates. According to the respondent, the exclusion from the amortization of the unrecovered prior period depreciation will result in Duquesne never recovering the full cost of the Shippingport station.

The staff asserts that regulation does not guarantee the recovery of every dollar of expense incurred by a utility and that it must be recognized that certain costs may not be recovered and may remain unrecoverable, as an incident of regulation. This is a risk which stockholders bear. The OCA witness, Mr. Henkes, argued that "sound regulation is prospective in nature and prospective regulation should not serve to make up for regulatory lag experienced in the past."

The ALJ agreed with the staff and the OCA reasoning, that respondent was never precluded from increas-

ing its claims for depreciation expense during this period. Since this expense could and should have been claimed over ten years ago, the ALJ recommends not burdening current ratepayers with this depreciation expense claim. The ALJ effectuated this recommendation by adjusting the claim, eliminating that portion of the Shippingport amortization claim which represented recovery of pre-1978 depreciation, thereby reducing Duquesne's claimed test-year operating expenses by $77,200 ($771,898 per ten years).

The respondent excepted to the ALJ's recommendation. Duquesne states that its depreciation expense adjustment has already accorded ratepayers the full benefit of the accumulated deferred tax reserve, despite the fact that the full amount of this deferral was never funded by ratepayer revenues. Thus, the respondent contends, the ALJ's adjustment gives the ratepayers a double benefit.

We concur with the ALJ's recommended disallowance of $77,200 of the Shippingport amortization claim. The essence of this claim is Duquesne's contention that the depreciation expense component contained in the rates charged to, and revenues received from ratepayers, represented less dollars of expense than was booked by the company. Duquesne states that this alleged underrecovery of depreciation expense was the result of regulatory lag; that is, the lapse of time between the end of the particular test year and the date that increased rates became effective. However, examination of Mr. Heller's testimony reveals that by far the vast majority of the claimed deficiency is the result of the company commencing the booking of depreciation in 1959 and the plant not being recognized in rate base until the fall of 1970. Additionally, there appears to be an

error claimed in the company's claimed depreciation reserve in the proceeding at R-811470, which was terminated by an "option order" rate increase filing.

Reduced to its bare essentials, the result which Duquesne seeks to achieve is to operate a plant for over ten years, during which time it has booked depreciation, and then over twenty years from the date it went into service request recovery of the difference between the depreciation booked and that depreciation expense supposedly recovered to rates. A necessary premise to Duquesne's claim is that until a specific plant is explicitly recognized in a given set of tariff rates, it does not recover any depreciation expense applicable to that plant. In our view this premise is not valid. It is entirely possible that in a period of expanding sales, increased revenues match and even exceed the increased depreciation expense applicable to new plants placed in service to provide the increased kilowatt-hours of sales. Insofar as the claim relates to an error in the claimed depreciation reserve in the proceedings at R-811470, we decline to consider what amounts to an after-the-fact reconsideration of that proceeding, especially where the proceeding terminated in "option order" rates.

In our order in Pennsylvania Pub. Utility Commission v National Fuel Gas Distribution Corp. ([1980] 54 Pa PUC 401, 40 PUR4th 101), we were considering a somewhat analogous claim and said:

"In addition to being unable to accept or even seriously entertain the necessary premises underlying the respondent's claim, were we to do so would mean the entire Pandora's box of past operations would require examination to consider all the concomitant expense and revenue items, in order to reach a conclusion as to what, if

any, earning deficiency may have suffered as a result of placing new plant in service from time to time. Even a momentary consideration of the magnitude of the effort involved to make such an examination of past operations, impresses upon us the wisdom of the regulatory principal [sic] that rate making is to be prospective in nature only, and that the quagmire of the past is to be ignored." Id., 54 Pa PUC at p. 407, 40 PUR4th at p. 107.

The respondent's claim here, claiming as it does a failure to earn the amount of depreciation expense booked for Shippingport, is a part of the quagmire of the past, and for this reason is the type of claim which we shall not entertain.

4. *CAPCO Cancellation Costs*

In the instant proceeding, as in its last two rate proceedings at R-80011069 and R-811470, Duquesne claimed a ten-year amortization of its investments in four canceled nuclear units: Davis Besse Unit Nos. 2 and 3 and Erie Unit Nos. 1 and 2. Duquesne's revised claim in this proceeding is for $3,469,739 per year for a ten-year period. In prior rate cases we deferred ruling on the cancellation charges issue, pending the outcome of the Central Area Power Coordination Group (CAPCO) investigation at I-79070315.

The respondent has noted that on October 25, 1982, Administrative Law Judge Joseph P. Matuschak issued his report of investigation at I-79070315. Then, relying upon the fact that ALJ Matuschak recommended, therein, that we permit Duquesne to amortize its portion of the cancellation costs of these plants, in appropriate rate cases over a period of ten years, with no return on the unamortized portion thereof, it argues that the

record in this proceeding, through its incorporation of the record in the proceedings at I-79070315, provides a basis for approval of its claim in this proceeding. Duquesne also notes that FERC has approved the ten-year amortization of these cancellation costs for accounting purposes, beginning with the recovery of such costs from the Duquesne's customers. Duquesne also calls to our attention that on December 31, 1980, it filed a petition with us, docketed at P-80120255, seeking permission to amortize for accounting purposes its $34 million investment, in accordance with the accounting treatment approved by FERC. Duquesne states that such costs must be charged to income in the year of disallowance, if the commission does not allow such costs to be recovered from ratepayers.

Duquesne's proposed adjustment was opposed by the staff, the OCA, and the commercial complainants. The staff argued that until the CAPCO investigation was completed we would be unable to make a fully informed decision as to the prudence of the original decision to build these nuclear units, and related issues. In addition, the OCA pointed out that it intended to file exceptions to ALJ Matuschak's recommended decision and the commercial complainants argued the merits of the adjustment, maintaining that no cost should be allowed. Pennsylvania Alliance for Jobs and Energy and the commercial complainants also oppose amortization.

The ALJ, first, noted that the commission at R-80011069 determined that any decision on the recoverability of these CAPCO cancellation costs should await the outcome of the pending investigation at I-7907315 ([1982] 50 PUR4th 272). Then, the ALJ stated that the conclusions reached by ALJ Matuschak are not final

and, therefore, concluded that it would be inappropriate to resolve the matter at that time.

The respondent filed an exception to ALJ's recommendation, arguing that to further delay an allowance for recovery of these dollars would be grossly unfair.

Events have overtaken much of what the parties have said by way of brief. The investigation at I—79070315 has been concluded. At public meeting of January 7, 1983 we adopted ALJ Matuschak's report of investigation dated October 15, 1982. Through our adoption of ALJ Matuschak's report of the investigation, we passed upon the merits of Duquesne's request to amortize their cancellation costs relating to Davis-Bessie Nos. 2 and 3 and Erie Nos. 1 and 2, in appropriate rate cases, in such amounts as therein determined, over a period of ten years, with no return on the unamortized balance thereof (exclusion from rate base).

The respondent's claimed investment in the cancelled units is $34,697,389 with a claimed ten-year amortization of $3,469,739. The dollar amount of the respondent's claim was not contested by any party. Accordingly, we shall approve the respondent's claim for $3,469,739 in this proceeding.

5. *Decommissioning and Spent Fuel*

At pp. 38 and 39 of the recommended decision the ALJ summarized Duquesne's expense claim for the decommissioning of Beaver Valley Unit No. 1 facility and the disposition of spent fuel as follows:

"Duquesne claims $245,615 as an expense item to provide for the decommissioning of Beaver Valley No. 1. This claim is consistent with the commission's earlier allowance in R-80011069. The methodology used in the

company's annuity calculation is identical to that previously accepted by the commission except that the tax-free interest rate used was updated to 9 per cent.

"The claim is uncontested and should be adopted.

"The company also claimed $2,667,000 for disposition of spent fuel from the Beaver Valley Unit No. 1 facility.

Duquesne's spent fuel claim in this proceeding is based on a program which has been developed by the federal government and approved heretofore by this commission. The essential elements of this program are summarized as follows:

"1. On site storage following discharge from the reactor.

"2. Prior to 1997, shipment of the fuel at utility expense to a federally operated interim storage facility (away from reactor) and the payment of $108 per kgu to the federal government to cover the cost of interim storage. The dollars associated with interim storage have previously been disallowed by this commission and without prejudice have not been claimed in this proceeding.

"3. Prepayment of a portion of the cost will be required prior to delivery for disposal.

"4. After 1997, shipment of spent fuel to a federally operated permanent storage depository.

"The Department of Energy estimates the costs for the ultimate disposal of spent nuclear fuel of $234 per kilogram of uranium. It is assumed that Beaver Valley will be shut down approximately annually for refueling and that about 52 spent fuel elements, having a total of 23,993 kilograms of uranium, will be discharged at the time of each refueling. The company's $2,667,000 claim

is based upon the $234 per kilogram cost times 223,993 kilograms times Duquesne's 47.5 per cent ownership.

"This claim is consistent with prior treatment of the issue and no party has contested its appropriateness. It should be adopted."

As noted above by the ALJ, the claims are uncontested and consistent with our prior decisions. Accordingly, we adopt the ALJ's recommendation and approve the respondent's claim.

6. *Edison Electric Institute and Electric Power Research Institute Dues*

Duquesne claims $315,000 for Edison Electric Institute (EEI) dues. Edison Electric Institute is an association of investor-owned electric utility companies. Duquesne's witness, Mr. Messner, described the benefits allegedly received by the ratepayers through the programs and activities of the institute, as follows:

"Helps electric companies generate and distribute electric energy at the lowest possible price, consistent with safe and reliable service;

"Advances the art of producing, transmitting, and distributing electricity including promoting scientific research to meet the need for electric power through environmentally acceptable means;

"Gathers and makes available factual information, data, and statistics of importance to customers and the industry;

"Serves the public and its government representatives by keeping them informed of all material matters relating to the generation and use of electricity in the United States, and speaks out effectively on the public

policy issues confronting the industry and electricity consumers."

The respondent's claim consists of $207,000 representing dues for regular activities and $108,000 which represents 1982 media communication dues. The claim for $207,000 relates to normal annual membership dues and has not been contested. Accordingly, we shall grant the claim of $207,000 representing dues for regular activities.

The OCA and the staff contest the expense claim representing the 1982 media communication dues. Both parties consider the programs to be lobbying efforts which do not directly benefit ratepayers.

The respondent contends that media communication dues represent expenditures for the purpose of informing the public regarding energy needs, energy sources, and the viability of the electric utilities, all to the ultimate benefit of ratepayers.

The ALJ considered the record to be replete with examples of EEI-sponsored media advertising dealing with such items as energy conservation. Although the ALJ did acknowledge that the benefit of some advertisements is less clear, he concluded that the record supports a finding that a substantial portion of this program is for media programs beneficial to ratepayers.

The staff and the OCA have filed exceptions arguing that the EEI's national media efforts are of a lobbying nature primarily aimed at increasing revenues.

While Duquesne claims ratepayer benefits, both the staff and the OCA have pointed out some specific instances where media communications programs did not, in our view, effectively benefit Duquesne ratepayers. On

balance, we are not satisfied that this expense results in direct benefits to Duquesne ratepayers. Therefore, we shall deny respondent's claim for $107,000 representing 1982 media communication dues.

The respondent has also claimed $2,887,000 for Electric Power Research Institute (EPRI) dues. Respondent states that for a number of years, a substantial amount of Duquesne's research and development (R & D) expenditures have been for the work of EPRI, which was founded in 1972 by the nation's electric utilities to develop and manage a nationwide co-operative industry research program for improving electric power production, transmission, distribution, and utilization. Respondent further states that the main purpose of EPRI is to develop improved technologies which can meet the changing needs of existing power systems and to foster the development of advanced alternatives for expanding those systems, while minimizing capital and operating costs, to the benefit of both the utility and the ratepayers. Respondent contends that the record in this proceeding contains numerous examples of ratepayer benefits from EPRI, both generally and specifically.

The ALJ's comments regarding the claimed benefits received by ratepayers through Duquesne's association with EPRI is set forth at pp. 42 and 43 of the recommended decision and is as follows:

"According to the company, these R & D findings have been transferred and utilized by Duquesne. Duquesne has representatives directly participating on various committees and receives extensive information through seminars and conferences sponsored by EPRI. Duquesne utilizes computer codes and data packages of EPRI with substantial cost savings. Duquesne depart-

ments, particularly the environmental affairs department, power stations department, nuclear department, and system planning, have benefited from EPRI technical reports with substantial savings in time and expense. Duquesne has utilized EPRI test facilities for significant savings. In particular, the Waltz Mill cable test facility produced a cable with reduced insulation thickness. This reduced wall cable saved Duquesne $500,000 on recent underground transmission projects and is expected to save more in the future. Additionally, Duquesne has utilized an EPRI program for nuclear safety relief valve testing which has resulted in an estimated savings of $1.5 million. There are other cost savings to the company that have also resulted from EPRI research projects contained in the record."

Duquesne's claim is opposed by the staff and the OCA. The staff first states that the claim ($2,887,000) represents 1983 expense levels for EPRI dues which creates a mismatch of revenues and expenses and therefore distorts the test year. Second, the staff argues the expense level claimed by Duquesne exceeds, by a substantial margin, the $885,634 EPRI expense level approved by the commission in R.I.D. 373. The staff proposed a reduction of $2,001,566 in the respondent's claimed operating expense to the $885,634 level previously allowed. Alternatively, the staff proposes a limit of a $1 million increase in the previously approved level of EPRI expenses, to reflect a more gradual movement toward the level of membership dues requested by EPRI.

The OCA would reduce the respondent's proposed test-year expenses by $1,623,000 to reflect "past commission policy."

The ALJ recommended rejection of the proposed adjustments to Duquesne's claimed operating expense for

EPRI dues and approval of the respondent's claim. The ALJ concluded that both the staff and the OCA had failed to rebut the extensive record evidence that payment of these dues are in the public interest or to justify limiting Duquesne's expense allowance to the 1974 level.

In Pennsylvania Pub. Utility Commission v Duquesne Light Co. (1981) 54 Pa PUC 695, 43 PUR4th 27, we reluctantly approved Duquesne's claim for EPRI dues of $885,634 which were actually paid in the test year. There, we relied primarily upon prior precedent in approving the claim, being of the opinion that Duquesne's showing that ratepayers benefited from the activities of EPRI was sorely deficient. In this proceeding, we find that the respondent has substantiated its claim that ratepayers do benefit from Duquesne's membership in EPRI. Therefore, we shall approve the respondent's entire claim in this proceeding.

7. *Emergency Energy Surcharge*

Duquesne seeks to include $1,101,116 in its test-year level of operating expenses, which represents unrecovered purchase power costs incurred as a result of the 1977-78 coal strike, not recovered through the then existing fuel clause.

Duquesne originally filed a petition at R-78010548 requesting permission to establish, for a limited period of time, an emergency energy surcharge of three mills per kilowatt-hour. By order entered March 2, 1978, at R-78010548, we granted Duquesne a surcharge of two mills per kilowatt-hour and limited collection of the surcharge to the period ending June 30, 1978. In response to Duquesne's petition for reconsideration, filed March 17, 1978, we entered an order on March 30, 1982,

which removed the time limitations for collecting the surcharge and directed that Duquesne file a plan for equal billing of the surcharge to all customers.

Duquesne filed monthly reports which indicated that $13,893,434 of excess purchased power costs were incurred and $11,691,202 was recovered from February, 1978, through August, 1978. Duquesne's claim reflects a two-year amortization of the unrecovered costs of $2,202,232 or $1,101,116.

The staff and the OCA oppose this claim. Both parties consider these 1977-78 unrecovered costs to be too remote to be appropriately included in future rates, based on a 1982 future test year. The staff notes that these expenses will not be incurred in 1982 or at any time in the future and if allowed would overstate operating expenses during the period rates are in effect.

Duquesne contends that this commission granted West Penn Power Company recovery of its emergency energy costs by order entered February 5, 1981, at R-80021082. Duquesne also asserts that the circumstances that existed in R-80021082 are substantially the same as in the present proceeding.

The ALJ first notes that since these costs were incurred there have been three successive rate applications filed by Duquesne where recovery could have been requested. The ALJ then recommended denial of the claim, concluding that these 1977-78 unrecovered costs were too remote in time to be included in future rates. Duquesne excepts to the ALJ's recommendation, reiterating the matters previously stated.

We approve the claim based upon, and consistent with, our action in Pennsylvania Pub. Utility Commis-

sion v West Penn Power Co. (1981) 54 Pa PUC 602, wherein we approved an expense allowance designed to recover similar costs over a two-year period.

8. *Net Negative Salvage*

Duquesne's income statement includes an amount representing the amortization of experienced net negative salvage during a five-year period. This amounts to $2,806,436. The manner in which the negative net salvage was calculated is consistent with Duquesne claims approved in prior proceedings. No evidence contesting this claim was submitted by the other parties and the ALJ recommended approval.

Duquesne's claim for net negative salvage is reasonable and is approved.

9. *Management Audit Expenses*

Duquesne increased its future test-year operations and maintenance expenses by $179,342 to reflect the annual amount of a three-year amortization of the management audit mandated by the commission. Duquesne asserts that the commission has historically allowed amortization of public utility commission (PUC) mandated management audit expenses.

The OCA opposed this claim arguing that this nonrecurring expense distorts the normal level of operating expenses for the test period. The staff proposes a five-year amortization period which reflects the period of time that the benefits of these extensive audits will be realized by the respondent in terms of better services.

The ALJ considered a three-year amortization period more reasonable and recommended approval of the respondent's claim. In making this recommendation, the ALJ noted the fact that the respondent's stockholders

have already borne one year's carrying costs for these expenses. The staff excepted to the ALJ's recommended approval of a three-year amortization period.

We adopt the ALJ's recommendation of a three-year amortization period as being more reasonable than the five-year period urged by the staff. The staff's exception is denied.

10. *EEOC Settlement Costs*

Duquesne claims $183,333 in annual operating expenses, which reflects a three-year amortization of Equal Employment Opportunity Commission (EEOC) settlement costs. Duquesne states that on September 4, 1975, the United States Department of Justice filed a complaint, in the United States district court for the western district of Pennsylvania, charging that Duquesne's assignment and preemployment selection criteria violated Executive Order No. 11246, and requested both injunctive relief and the payment of compensation to persons allegedly harmed as a consequence of Duquesne's wrongful conduct. On March 1, 1976, the complaint was amended to name the national and local unions representing Duquesne's employees as additional defendants.

On December 29, 1976, the federal Equal Employment Opportunity Commission filed suit, in the United States district court for the western district of Pennsylvania, against Duquesne and the national and local unions representing the Duquesne's employees, alleging that the company's employment practices, including assignment and preemployment selection criteria, violated Title VII of the Civil Rights Act of 1964, by discriminating against minorities and females. The complaint sought both injunctive relief and the payment of

compensation to persons allegedly harmed as the result of Duquesne's alleged wrongful conduct.

By order dated March 7, 1977, the court consolidated the two cases for trial purposes only. By order dated March 27, 1980, the court dismissed all claims against the company concerning acts or practices at its Warwick mine facilities. Duquesne, through its counsel, has submitted a consent decree to the government in an attempt to settle the cases.

Duquesne considers costs of litigation and settlement to be normal and ordinary costs of doing business and properly recoverable.

Both the staff and the OCA contest this claim. The staff considers the cost of defending allegations of unlawful management practices costs properly to be borne by stockholders. The OCA takes the position that the inclusion of these nonrecurring expenses, in the overall level of operating expenses, is inappropriate because it distorts the normal level of operating expenses for the test period.

After noting that Duquesne has not been found guilty of these charges, the ALJ acknowledged the fact that Duquesne will, if the consent decree is adopted, be required to pay $500,000 in damages to the complainants in the EEOC cases, by reason of alleged discriminatory hiring and employment practices. The ALJ then concluded that the ratepayers should not have to bear such expenses.

Duquesne excepted to the ALJ's recommendation and again urged that litigation costs are an ordinary cost of doing business and should be allowed as an ordinary expense.

Having considered the evidence and the contentions of the parties, we find that, while the expense claimed is one which is incurred in the business world from time to time, Duquesne has not satisfied its burden of proof that the claimed expense is a reasonable and necessary expense incurred to provide utility service. The claim is rejected and the respondent's exception is denied.

11. *Deferred One Oxford Centre Costs*

Duquesne seeks to increase operations and maintenance expenses by $38,841 to provide for the five-year amortization of deferred costs of $194,230, which represent engineering and consulting costs associated with the transfer of its corporate headquarters to One Oxford Centre. Duquesne asserts that these costs were incurred in order to ensure that the new offices would meet its needs. Duquesne's position is that amortization of such nonrecurring costs is in accordance with prior commission decisions.

Based upon the long-term nature of benefits derived from the engineering and consulting services, the staff argued that it would be more appropriate to amortize these costs over the life of the lease; i.e., twenty years.

The ALJ agreed with staff's position and reduced the respondent's claimed operating expenses by $29,129 to reflect a 20-year amortization. The ALJ, noting that customarily leasehold improvements are to be amortized over the life of the lease, analogized that associated services should be similarly amortized.

Duquesne has excepted to the ALJ's recommendation, pointing out that the analogy is improper in that leasehold improvements are assets which are includable in rate base, and that the instant costs will not be accorded rate base inclusion. Moreover, Duquesne argues, the

ALJ's adjustment is inconsistent with the fact that these expenses are the types of costs which will recur with the subsequent occupancy of new power stations, office buildings, and other facilities. Finally, Duquesne argues, these costs are no different than other implementation costs such as installation of computer equipment which, it states, the commission has traditionally amortized over five years rather than capitalized and depreciated over the equipment's life.

We note that no party took issue with the allowance of this claim, even though it represents an expansion of the types of expenses historically granted amortization treatment by this commission. As opposed to merely litigating the question of an appropriate amortization period, which is basically a judgmental decision, we would rather have seen the parties address the threshold question, which is whether this nonrecurring expense is one which should be accorded amortization treatment.

While we are not necessarily persuaded by the ALJ's rationale for adjusting the respondent's claimed operating expense to reflect a 20-year amortization of these deferred costs, we shall adopt his recommendation, without expressing any final conclusion, at this time, on the basic question as to whether amortization treatment is appropriate.

12. *Residential Conservation Service*

Duquesne increased test-year operations and maintenance expenses by $115,400 to reflect that portion of the expenses of the residential conservation service program (RCS), not directly recovered from rate-payers, in accordance with our order at 1-80010329. No evidence contesting this adjustment was submitted by any party, and the ALJ recommended that we approve the adjustment.

We find Duquesne's claim for RCS expenses reasonable, and it is approved.

13. *Maintenance Expenses—Account 513*

Duquesne states that it incurred $6,782,000 in Account 513 (prime movers, generators, and accessory electric equipment) expenses in 1981, and budgeted $6,746,000 for 1982.

The staff states that the respondent's experienced 1981 expenses in this account were $2.6 million over the 1980 maintenance expenses and the respondent has continued this same level of expenses in its 1983 budget. The staff witness, Mr. Jones, contends that an analysis of the reasons for this increase in 1981 maintenance expenses, reveals that approximately $2 million of the $2.6 million increase can be accounted for by the major maintenance work which was performed at the Cheswick plant in 1981. He concludes that the Cheswick plant maintenance expense was of a nonrecurring nature and asserts that the respondent has ignored the nonrecurring nature of this expense in developing its 1982 projections. The staff, therefore, recommends that the amount budgeted for Account 513 maintenance expenses for 1982 be reduced by $1,570,191 based upon five-year amortization of the major inspection and overhaul at Cheswick.

Duquesne argues that by simply looking at one plant or one account the staff fails to consider the entire system and the ongoing level of such expenditures. Duquesne emphasizes that it is the overall level of maintenance expense which should be considered for rate-making purposes. Finally, Duquesne states, that the actual 1982 expenses through August were slightly above budget.

The ALJ rejected staff's proposed adjustment. The ALJ agreed with the respondent that it is the overall level of maintenance expense which is significant, since the level at each individual plant may vary from year to year. The ALJ also appears to have been impressed by the apparent fact that 1982 actual expenses are running slightly higher than budgeted.

The staff has excepted to the ALJ's recommendation, arguing that following the ALJ's approach of considering the respondent's entire maintenance program would effectively limit the commission's ability to examine the reasonableness of Duquesne's future test-year claims.

In view of the fact that 1982 actual expenses are running slightly higher than budgeted, the respondent's claim appears to be reasonable and it is approved.

14. *Maintenance Expenses—Account 552*

The staff proposed a similar adjustment to Account 552 (maintenance of structures—other power generation). The staff contends that the data provided by the company, reveals that the substantial increase in the 1982 budgeted amount for Account 552 maintenance expenses, was due primarily to the $300,000 painting project, performed eight years ago, at the Brunot Island plant. Accordingly, the staff witness, Mr. Jones, recommended that the 1982 budgeted amount for Account 552 maintenance expenses, be reduced by $262,500 to reflect an amortization of these nonrecurring maintenance expenses (Brunot Island painting) over eight years.

Duquesne again argues that the staff has singled out expenses incurred at one station, without considering the overall level of expenses. According to the respon-

dent, Account 511 (maintenance of structures—steam power generation) and Account 552 are interrelated for budgetary purposes. While Account 552 has increased $270,000, Duquesne states that Account 511 for the remainder of the facilities has decreased by $152,000 which results in a net total increase of about $118,000, or less than five per cent over 1981 costs, without any consideration for inflation. Moreover, the respondent notes, these accounts (511 and 552) cover all facilities maintenance at coal- or oil-fired stations such as roof repairs, road and grounds maintenance, and services such as water and sewage.

The ALJ found the respondent's position to be meritorious and recommended approval of the claim. The staff excepts to the ALJ's recommendation, arguing that the above mentioned adjustment should be made to reflect the nonrecurring nature of this expense.

For the reasons stated previously, we shall again adopt the ALJ's recommendation that the respondent's expense claim be approved.

15. Legal Expenses

Staff proposed an adjustment to the respondent's estimated claim for 1982 legal expenses of $1,595,000. Both the staff and the OCA consider the claim to be excessive. The relevant data is as follows:

ACCOUNT 923.101 LEGAL SERVICES

1979	$ 850,169	—
1980	902,417	+ 6.1%
1981	1,323,683	+46.7%
1982 (est)	1,595,000	+20.5%

Staff emphasizes that the respondent's budget projects 1982 legal expenses to increase by an additional 20.5 per cent beyond the level already incurred in 1981.

The staff argues two points in support of its position that the expenses are overstated or excessive. First, the 46.7 per cent increase in 1981 is unusually large and should be considered an aberration in the trend of mounting legal expenses. Second, actual legal expenses for the first six months of 1982 were $521,276—for a 1982 annualized level of $1,042,552. Since the 1982 annualized level, based on actual expenses, is substantially less than the budget estimate for the year, the staff concludes that the respondent's 1981 legal expenses were unusually high and not reflective of a normal level.

The staff proposes that the 1982 legal expenses be normalized to reflect the 1980-82 three-year average of $1,273,833 in lieu of the $1,595,000 claimed by the respondent. This would result in a reduction of $321,167 in the respondent's claim.

The OCA proposed that the respondent's claim for legal expenses be reduced by $181,000 to reflect actual experience for the first six months of 1982, which is lower than estimated.

Duquesne contests the staff's proposed adjustment, arguing that as of September 30, 1982, the actually incurred "other operation expenses" (including legal) were above budget, while net operating income was below budget. Duquesne, first notes that the staff has not proposed an adjustment to pick up these deficiencies, then concludes that the staff's unsubstantiated adjustment is improper and should be rejected.

The respondent's data indicating that total operating expenses were exceeding budgeted amounts was given little weight by the ALJ. The ALJ adopted the staff's adjustment. The ALJ viewed the three-year average as a better basis for estimating this expense, which, in

turn, is supported by respondent's experienced legal expense level for the first half of 1982.

Duquesne excepted to the ALJ's recommended adoption of the staff's adjustment. Duquesne argues that the adjustment is improper since there has been no challenge to the reasonableness of any item, and no consideration given to the intervening inflation between 1980 and 1982 or the additional legal services required. According to Duquesne, the ALJ misunderstood the evidence and its contention. Duquesne argues that it did not make a comparison on the basis of "company-wide" actual total operating expense but rather based its comparison on expense "other" (including legal).

We agree with the ALJ's recommendation that the staff's adjustment be adopted. The normalization of 1982 legal expenses, proposed by staff, reflects a reasonable level of expense for the test year. As noted by the ALJ, the 1982 annualized level, based on actual expenses for the first six months of 1982, is substantially less than the budget projection for the year. It appears that respondent has overbudgeted 1982 legal expenses. Respondent's exception is denied.

16. Amortization of Beaver Valley No. 1 Ice Damage Expenses.

Duquesne has made an upward adjustment of $127,559 which is designed to recover, over a three-year period, the costs of repairing the Beaver Valley No. 1 cooling towers, which sustained ice damage during the winters of 1976-77 and 1977-78.

The staff and the OCA object to the adjustment proposed by Duquesne. It is the staff's view that the ice damage sustained by the Beaver Valley No. 1 cooling tower resulted from the inherently faulty design of the

structure. The staff states that Duquesne reached a settlement with the engineers and architects responsible for the poor design and recovered all but approximately $383,000 of the $1.7 million damage sustained. It is the staff's position then that, in effect, Duquesne is proposing that the ratepayers become the insurers of last resort through this proposed adjustment. The staff argues that ratepayers already insulate the respondent from property damage expenses through payment of insurance premiums and legal fees and that if these measures do not fully insulate the respondent from its casualty losses, then the staff is of the opinion that the risk should then be borne by stockholders.

The OCA has taken the position that the claim could have been filed earlier and should be rejected for untimeliness.

Duquesne states that ice damage to cooling towers is not an uncommon event, because moisture laden vapor rising up the tower condenses, and in cold weather may form a substantial buildup of ice, causing damage. Duquesne asserts that the unrecovered costs ($383,000) are akin to the deductible coverage generally provided in insurance policies. Citing Pennsylvania Pub. Utility Commission v Pennsylvania Gas & Water Co. (1981) 55 Pa PUC —, as authority for its adjustment, Duquesne states that its staff's position should be rejected.

The ALJ was in agreement with the arguments proffered by the staff and recommended rejection of the proposed adjustment. The ALJ also considered the question of remoteness in rejecting the respondent's claim. Duquesne excepted to the ALJ's recommended rejection of the proposed adjustment, arguing again that

there is no evidence that the damage occurred as a result of design imperfections.

The PG & W case cited dealt with cold weather storm damage amortization, which has been customarily permitted. Duquesne's initial capitalization of the damage expense belies its position that the damage in question is of the nature for which we have historically permitted amortization. The damage in question was suffered approximately five years ago. Further, it is remote in time. In this instance, had this expense been initially amortized, it would have been recovered in rates or absorbed by the company some time ago. We shall not entertain it at this time. The adjustment is rejected and Duquesne's exception is denied.

17. *Other Advertising Expenses*

Duquesne has claimed some $860,000 for advertising expenses.

The OCA witness, Mr. Henkes, proposed that $162,000 of "other advertising expenses" be eliminated. The OCA does not dispute that the majority of the advertising expense claim relates to health and safety, conservation, rates and billing practices, and education. That amount the OCA does, at least tacitly acknowledge as reasonable and appropriate, saying that the balance of this expense claim consisting of $162,000 is that which Duquesne has incurred through its support of Edison Electric Institute's special post-Three Mile Island communication activities. The OCA argues that there is no public benefit from such advertising.

Duquesne contends that such advertising is pursued in order to better inform the public of issues related to the growing national concern of the safety of nuclear power generation.

The ALJ recommended allowance of the claim, concluding that the expense was of a minor nature and does serve the public interest. The OCA has excepted to the ALJ's recommendation. In the opinion of the OCA, forcing ratepayers to fund this campaign is unconstitutional and inequitable, regardless of the cost.

While we do not necessarily agree with OCA's position we fail to see how this expense is of benefit to Duquesne's ratepayers. Accordingly, the OCA's exception is granted and the claim is denied.

18. *Interest on Customer Deposits*

Consistent with our adoption of the ALJ's recommendation that customer deposits be deducted from rate base, we are increasing the test-year level of operating expenses by $153,000 to reflect the 9 per cent interest paid to customers on customer deposits.

B. *Depreciation Expense*

Duquesne's annual depreciation expense claim for Pennsylvania jurisdictional operations is $66,706,000. No party has taken issue with this claim. We find the claim reasonable and it is accordingly approved.

C. *Taxes*

1. *Amortization of Deferred Federal Income Tax*

A large portion of Duquesne's deferred federal income tax reserve was collected from ratepayers at a 48 per cent rate, existing at the time of the individual rate proceedings, until January 1, 1979. On January 1, 1979, the marginal tax rate was reduced to 46 per cent, the current marginal tax rate. As Duquesne had previously accrued amounts at the 48 per cent rate, the reserve for deferred taxes is overaccrued. The OCA

proposes that the excess 2 per cent or $2,149,200 be amortized to income over a three-year period.

After acknowledging that the commission has flowed back this excess in other proceedings, Duquesne contends that the evidence of record in this proceeding indicates the inappropriateness of any adjustment. The respondent's witness, Mr. Ellenberger, stated that "[w]hen the accumulated deferred balances are amortized back to income, they are done so by applying the tax rate in effect when the deferrals were created." Mr. Ellenberger considers this treatment to be sound because, allegedly, it is in accord with generally accepted accounting principles and regulatory pronouncements. Additionally, the respondent states that other commissions have refused to make any adjustment for the change in the federal income tax rate.

The ALJ concluded that there was no dispute that the excess be returned to the ratepayers, but, rather, the question being the amortization period. The respondent's position is that the excess should be amortized over the remaining tax life of the property, some twenty to thirty years. The ALJ found Duquesne's method for returning the amount unacceptable, since ratepayers would not receive any benefits until well into the future, citing Pennsylvania Pub. Utility Commission v Philadelphia Electric Co. (1980) 54 Pa PUC 1, 33 PUR4th 319, for this conclusion. Thus, following what he believed to be past commission practice, the ALJ ordered a five-year amortization period.

Duquesne and the OCA have both filed exceptions to the ALJ's disposition of the deferred tax amortization issue.

Although Duquesne admits that its normal procedure would be to flow back the deferrals over the life of the property, it argues that a significant portion of these deferrals were not contributed by ratepayers. The respondent contends that of the $2,149,000, a total of $900,000 were not ratepayer funds. Further, Duquesne contends that the ratepayer has received the full benefit of a rate base reduction of that amount.

In its exceptions, the OCA notes that the cases relied on by the ALJ in using the five-year payback period were decisions made in early May of 1979 (Pennsylvania Pub. Utility Commission v Philadelphia Electric Co. [1980] 54 Pa PUC 1, 33 PUR4th 319 and Pennsylvania Pub. Utility Commission v Philadelphia Electric Co. [1980] 37 PUR4th 381, 54 Pa PUC 220), nearly four and three years, respectively, from the time a decision will be reached in this proceeding. The OCA argues that a three-year period is more consistent with the early decisions to use five-year period, because of the passage of time since those early decisions.

Having considered the contention of the parties, we conclude that a three-year amortization period is appropriate, particularly in light of the relatively modest amount involved. Consistent with this conclusion the OCA's exception is granted and that of Duquesne is denied.

2. *Normalization of State Taxes*

Duquesne is proposing the normalization of state income tax reductions attributable to (a) accelerated cost recovery system (ACRS) of the Economic Recovery Tax Act of 1981,[8] (b) liberalized depreciation based upon

[8]The respondent has petitioned to remove this item from this proceeding and have it considered at R-822173. The respondent's petition,

(Footnote continued on following page)

preasset depreciation range system (ADR) lives for capacity-increasing property acquired after 1970, and before 1981, and (c) liberalized depreciation based upon ADR lives for capacity-increasing property acquired after 1970 and before 1981. Duquesne argues that normalization of income tax benefits arising from liberalized depreciation, ADR, ACRS, and the job development and investment tax credits is required by federal law or established by commission precedent, and essential to the equitable distribution of those tax benefits to the customers.

The OCA takes the position that the commission should not impose the burden of normalization of state income tax reductions upon ratepayers for the purpose of improving the respondent's cash flow. While the OCA acknowledges that our past "flow-through" policy has been altered in the recent Pennsylvania Power Company case at R-811510, January 22, 1982, and the recent Philadelphia Electric Company case at R-811626, May 21, 1982, the OCA argues that due to the severe economic conditions in the respondent's service territory the imposition of this "noncost" upon ratepayers is unreasonable. The OCA also contends that while federal income taxes may be required to be normalized, state taxes are not. The ALJ, citing commission precedent on this issue, recommended that state income taxes be normalized. The OCA has excepted for the reasons previously stated.

(Footnote continued from previous page)

filed on September 30, 1982, at R-822173, requested that the commission, in an order entered before January 1, 1983, authorize the normalization required by the Economic Recovery Tax Act of 1981, in order that Duquesne will be able to avail itself of the accelerated cost recovery system (ACRS) benefits for post-1980 property. This subject is addressed below.

We adopt the ALJ's recommendation. The ALJ's recommendation is entirely consistent with our past disposition of such claims. See Pennsylvania Power Co., R-811510, Jan. 22, 1982; Philadelphia Electric Co., R-811626, May 21, 1982; Philadelphia Electric Co. R-811719, June 25, 1982; Pennsylvania Pub. Utility Commission v Bell Teleph. Co. of Pennsylvania, R-811819, Sept. 3, 1982; Pennsylvania Pub. Utility Commission v UGI Corp. R-821899, Dec. 17, 1982. Specifically, in the Pennsylvania Power case we granted the company's request to normalize state income taxes and relied upon the following rationale for our decision:

"We conclude that it is in the public interest that this request should be granted in its entirety. We do not believe that the company's current customers will be unduly burdened by this finding, and, more importantly, we believe such action is most fair to future customers. In addition, the allowance of the company's claim should improve its financial position with attendant benefits, not only to its investors, but to its customers as well." Id. at 27.

The OCA's arguments for flow-through treatment of state income taxes have not persuaded us to depart from our stated policy of normalization. Accordingly, the exception filed by the OCA is denied.

3. *Accelerated Cost Recovery System Issues*

On September 30, 1982, we received a petition by Duquesne to remove the issue of the appropriate treatment of the tax benefits associated with the accelerated cost recovery system (ACRS) from this rate proceeding (at R-821945). Duquesne also sought permission to put into effect the rates contained in Supplement No. 58 to Tariff Electric-Pa PUC No. 14 which provided for a

$15,475,000 annual revenue increase to reflect the normalization of the ACRS tax benefits under the Economic Recovery Tax Act of 1981, for the future test year ending December 31, 1982, and the normalization of the Pennsylvania corporate net income tax. By suspension and investigative order issued on November 5, 1982, at R-822173, we suspended the operation of Supplement No. 58 until a final order as to its reasonableness could be issued, which in no event would be later than December 31, 1982. On that same day, a hearing on the petition and supplement was held in Harrisburg before Administrative Law Judge (ALJ) Joseph J. Klovekorn where the respondent, the staff, and the OCA all participated.[9]

The staff took the position that Duquesne had overstated the minimum rate increase required to qualify it for ACRS depreciation with respect to post-1980 property additions. There (at R-822173), the staff urged the disallowance of that portion of the increase sought relating to 1982 property additions and that portion of the proposed increase based upon normalization of the state income tax benefits of ACRS depreciation with respect to 1981 and 1982 property additions. This would reduce the revenue increase proposed there to $5,842,023.

On December 1, 1982, ALJ Klovekorn issued a recommended decision which recommended granting Duquesne's petition for normalization, pursuant to § 168(c) of the Internal Revenue Code, of federal tax expense, with respect to depreciation deductions on post-1980 property additions, and further recommended that Duquesne be permitted to file a revised tariff

[9]The Pennsylvania Alliance for Jobs and Energy (PAJE), filed a response to Duquesne's petition, but did not participate.

supplement designed to produce $15,482,286 in additional annual revenues. Exceptions to the recommended decision were filed by Duquesne, the staff, the OCA, and Senator Leonard J. Bodak.

By opinion and order, issued December 17, 1982, we concluded that Duquesne demonstrated a need for additional annual revenues amounting to $5,842,023, and that the rate increase should be spread uniformly to all customer classes with no change in the existing customer charges. In arriving at this conclusion, we adopted the staff's recommendation that that portion of the requested income relating to 1982 property additions and that portion relating to the normalization of state income tax benefits, of ACRS depreciation, with respect to 1981 and 1982 property additions be denied at that time.

Pursuant to our December 17, 1982, opinion and order, Duquesne filed Supplement No. 61 to become effective December 18, 1982. In its reply exceptions, herein, Duquesne states that although these dollars ($5,842,023) are included in the Tariff No. 15 filed in this proceeding, the total revenue increase to be allowed must reflect the ACRS revenue requirement for both 1981 and 1982 additions, not just the 1982 additions. Duquesne stated it another way by asserting that the $5,842,023 should not be deducted from the amount of rate relief to be allowed in this proceeding, so long as revenue requirements shortfall at existing rates is based upon Supplement No. 52 levels.

In this proceeding, Duquesne has included in its claim, full normalization of both federal and state income taxes, relating to the application of ACRS depreciation rates over the depreciation expense resulting

from the asset lives used for rate making and the straight-line method used for rate-making depreciation, for all post-1980 property additions. We agree with Duquesne that since its entire showing in this proceeding is based upon Supplement No. 52 rates, no adjustment need be made here for the additional revenues allowed in Supplement No. 61, because those rates will be superseded by our allowance herein. Stated in another manner, our allowance herein will be cumulative, rather than an incremental allowance over Supplement No. 61 rates.

4. *Interest Adjustments*

The respondent states that interest charges must be allocated between utility and nonutility operations,[10] as required by Federal Power Commission Order No. 389, dated October 9, 1969, and as allowed by the commission in previous proceedings. For purposes of this allocation, the respondent has classified construction work in progress (CWIP) as "nonutility plant," consistent with its exclusion of these amounts from rate base. By reason of the $595,810,465 of construction work in progress, respondent allocated $43,705,671 in interest expense to nonutility operations. This amount was derived by utilizing the most recent debt interest rates which, it says, have in fact been used to finance CWIP.

The OCA contests the propriety of, and methodology employed by, Duquense. The OCA position is that the higher cost rates assigned by Duquesne CWIP is included in Duquesne's overall rate of return and consistent with paying a rate of return at this higher overall rate, ratepayers should enjoy the tax benefits associated with these higher interest costs. However, argues the OCA, the respondent's methodology has not accorded

[10]This results in an adjustment increasing state and federal income taxes.

ratepayers the benefit of the income tax deductions which accompany these high-interest costs.

Mr. Henkes, the OCA witness on this issue, recommends that a pro forma interest expense be used for purposes of computing test-year income taxes, and that it be set at $85,596,000, which is $15,609,000 higher than the $69,987,000 proposed by Duquesne. This reduces state and federal income taxes by $7,756,000.

With regard to this proposal, the respondent states that the CWIP which was financed by these new debt issues has not been included in rate base. Consequently, says the respondent, if the ratepayer does not pay a return on this capital and at the same time receives the benefit of an income tax reduction for the interest associated interest expense, he is receiving a double benefit.

The respondent has excepted with regard to the fact that the ALJ's calculation, found in his Table VI, does not conform to the conclusion reached in the text of the recommended decision.

The respondent's argument obfuscates the issue. The issue is not whether ratepayers should receive the income tax benefit of the interest expense related to CWIP, but, rather, whether the most recent and highest interest rates should be assigned to CWIP, while at the same time, by reason of its inclusion in the calculation of the embedded cost of debt, and thereby the allowed rate of return, ratepayers are obliged, at least in part, to pay the interest expense. To be consistent, if the respondent wishes to exclude the interest expense associated with the approximately $600 million of CWIP not included in rate base, then some $600 million of the highest cost debt should be excluded from the calculation of the embedded cost of debt, in order that ratepayers not be obliged to pay any of the interest expense associated

therewith. Stated another way, the inclusion of all of the higher debt cost in the embedded cost of debt calculation, obliges ratepayers to pay more by way of interest expense than is in fact experienced in relation to the adopted rate base.

For these reasons, we conclude that a pro forma interest expense calculation and income tax adjustment is required. The respondent's exception is denied.

There is another issue involved in the subject of interest expense for the purposes of the income tax calculation, which was not pointedly developed by the OCA witness. Respondent's estimated test-year interest expense is not annualized to the test-year-end level. Our customary calculation of a pro forma interest expense is prompted by the need to state it on the same basis as the test-year-end (or beyond) embedded cost of debt calculation[11] and the year-end rate base. Almost universally the product of the embedded cost of debt and the adopted rate base will exceed test-year interest expense. To the extent that ratepayers are obliged to provide this higher interest expense by way of income available for return, it is only appropriate that they enjoy the cost-reducing effect thereof, by way of a reduced income tax expense.

This subject provides yet another reason why a pro forma interest expense calculation is required. However, since we have adopted a slightly different cost of debt and rate base than proposed by the OCA, we must perform our own pro forma interest expense calculation and income tax adjustment.

The OCA has taken issue in another respect with Duquesne's interest expense and consequently its in-

[11]Not infrequently the embedded cost of debt which is adopted, includes consideration of a prospective-debt issue beyond test year-end.

come tax calculation. It states that Duquesne has excluded from it interest expense, that expense associated with that portion of rate base the funds for which are derived from unamortized job development tax credit (JDIC).[12] The essence of the OCA's position is that since ratepayers are required to provide a rate of return on that portion of plant funded by JDIC, to the extent that a portion of that rate of return represents hypothetical interest expense it should be offset, in part, by a hypothetical tax savings resulting from the tax deductibility of interest expense. The respondent's position is that the OCA's position is in error and was specifically rejected by the North Carolina Utilities Commission in Re Southern Bell Teleph. & Teleg. Co. (1982) 46 PUR4th 285.

The AJL found the North Carolina commission's reasoning persuasive.[13] The OCA has excepted and cites the decision of the U. S. court of appeals for the District of Columbia in NEPCO Municipal Rate Committee v Federal Energy Regulatory Commission (1981)—US App DC—, 668 F2d 1327, as approving an interest and tax expense treatment consistent with that which it advocates here. The OCA also cites our opinion and order in Pennsylvania Pub. Utility Commission v Pennsylvania Power & Light Co. (1981) 54 Pa PUC 645, as according similar treatment to investment tax credits. There we said:

"In calculating our dollar return, rate base times the rate of return, if the unamortized investment tax credit

[12]The OCA's pro forma interest expense calculation, based as it is on total rate base, includes interest expense associated with funds derived from unamortized JDIC and is, therefore, in conflict with his text.

[13]Although agreeing in principle with the respondent, the ALJ's calculation in Table VI of the recommended decision is based upon his total recommended rate base and therefore conflicts with his text.

is included in rate base, as required by federal law, the ratepayer would provide a return on those funds supplied by the government. To be consistent, the ratepayers should receive any benefit arising out of the inclusion of these funds in rate base. This benefit is provided by the deduction of the interest expense normally generated by debt for income tax purposes.

"Further, it is assumed that these government-supplied funds are a surrogate for debt, preferred, and equity capital which normally could be raised by outside financing. By applying a rate of return to these funds, we are treating them as if this capital was supplied in identical proportions to that supplied by the investor. Having applied the rate of return to these funds, were we to fail to accord them the same tax status as investor supplied, we would be creating an addition [sic] pool of dollars available for return to investors, effectively increasing the return on common equity.

"Under PP&L's (Pennsylvania Power and Light Company) proposal, ratepayers are being charged once for the tax expense, and a second time for a return on property paid for by the tax expense dollars, and would not be provided the benefit of the associated tax deduction for interest computation purposes. We find that the adjustment proposed by the OCA and trial staff reflect this benefit. We grant trial staff's and OCA's exceptions."

The reasoning set forth there is equally applicable here. The only question remaining then is whether this treatment is precluded by the Internal Revenue Code and/or Treasury regulations. We have closely examined

§ 46 of the Internal Revenue Code and § 1.46-6 of the U. S. Treasury regulations and based upon our analysis neither the code nor Treasury regulations require the exclusion of consideration of the applicable hypothetical interest expense in determining federal income tax expense for rate-making purposes. To paraphrase the thoughts expressed above in quotation from our opinion and order in the Pennsylvania Power and Light Company case, we have consistently chosen to accord those portions of rate base funded by investment tax credits and job development tax credits, an overall rate of return rather than an equity return. In doing so we have recognized that when translated into dollars in the form of income available for return, and hence to an operating revenue requirement, the overall rate of return produces a different (lower) operating revenue requirement than does equity at the same stated percentage rate, because of the difference in deductibility for tax purposes. Looking at the matter from a different perspective, although the income available for return provided on this portion of rate base, at an overall rate of return level, is an amalgam of hypothetical interest, preferred dividends, and equity return, Duquesne, for the purposes of income tax expense, is treating the income available for return as if it were entirely a hypothetical equity return. The result would be to force upon ratepayers a higher effective cost at the operating revenue level, which is what they in fact pay, than the stated return rate would normally indicate.

We find that many of these same thoughts were expressed by the court, or by the Federal Energy Regulatory Commission and viewed with favor by the court, in the NEPCO case. We quote at some length from that opinion:

"(3) *Calculation of NEP's Interest Deduction*

"In determining a utility's federal income tax expense (as an element of cost of service) for rate-making purposes, FERC must determine NEP's interest expense, a deductible item. To the extent that interest expense decreases, tax expense increases, and customer rates must be increased to pay the tax expense.

"In its December 31, 1979, order in W-2, FERC determined that NEP's interest deduction should be determined without regard to the tax credit. NEP argues that because FERC has already decreased cost of service by a ratable portion of the tax credit funds, the inclusion of those funds in the calculation of the interest deduction further reduces cost of service, producing in turn, says NEP, an overall return lower than the minimum mandated by the code and IRS regulations.

"The question in this section is whether FERC may properly treat tax credit funds in relation to interest deduction in the same way it treats tax credit funds in relation to rate of return determination. Federal Energy Regulatory Commission assumes that the company would, absent the credit, have acquired financing by using a combination of debt and equity in the same proportion they bear in present capitalization (less tax credit funds). That assumption creates an 'alternative utility' that might have evolved in the absence of tax credit funds. The capital structure so created is speculative but permissable, in view of the impossibility of determining exactly what financing, and consequent interest payment, the utility might have arranged absent the investment tax credit. As FERC noted:

"'The only administratively feasible approach is to assume that nothing except the source of cash would

have changed if the credits had not been available. The commission has thus determined that, for rate-making purposes, it will be assumed that in the absence of investment tax credits a utility would have financed the ADITC portion of its rate base with the same proportions of debt and equity, reflected in its capital structure by which it has financed the remainder of its rate base.'

"NEP and FERC offer contrasting and complex economic scenarios and relate them and their alleged results to § 46(1)(2)(A). As this court indicated in New Mexico, *supra*, however, our role does not entail economic speculation:

"'As a matter of economic theory, the competing theories advanced by FERC and PNM raise questions that are undoubtedly complex. The question before this court, however, is not. The function of this court is not to speculate on the manner in which a utility would finance investment in a world devoid of the investment tax credit. Since no issue of statutory interpretation is presented, the question before this court is simply whether the factual assumption relied on by the commission in applying the statute is arbitrary, capricious, or an abuse of discretion. We hold that it is not.' Id., 668 F2d at p. 689.

"This court went on to discuss application of the arbitrary/capricious standard to the issue presented here:

"'As discussed above, we believe that the commission's assumption of capital acquisition in the absence of the credit is not arbitrary, capricious, or an abuse of discretion. As a result, we affirm the commission's decision to exclude ADITC from capitalization. Assuming

that the capital otherwise provided by the credit would be supplied by debt as well as equity, the exclusion of ADITC from capitalization does not significantly affect the debt ratio. Consumers bear the same cost of service, excluding the ratable reduction permitted by the statute, as they would pay in the absence of the credit. No violation of § 46(f)(2) exists.' Id., 668 F2d at p. 691.

"Accordingly, we find no reversible error in FERC's approach to calculation of NEP's interest deduction. [Footnotes omitted]" Id., 668 F2d at pp. 1337, 1338.

We conclude that the court has specifically approved the calculation of interest expense as proposed here by the OCA and the method which we adopted in our opinion and order in the Pennsylvania Power and Light case. We shall adopt as interest expense for the purposes of income tax expense, the product of our adopted fair value rate base and the weighted cost of debt. Accordingly, the OCA's exception is granted and that of Duquesne denied.

In its exceptions Duquesne also states, with regard to the ALJ's interest calculation, that: "The calculation assumes that cash working capital is financed in part by debt. Both the consumer advocate witnesses admitted that cash working capital is financed by equity." Duquesne provides no record citations for the latter sentence, nor does it argue the correctness of this position. However, regardless of the view or position of the witnesses, it has never been our position, nor to our knowledge has this commission ever taken the position, that cash working capital is funded in its entirety by common equity. If we were to accept Duquesne's position, then the capital structure to be applied to a rate base excluding cash working capital must of necessity be modified to increase the debt and preferred stock

component and decrease the equity component. We conclude that if the capital structure is modified to reflect the 100 per cent equity cash working capital, the product of this alternative calculation, which is interest expense, will be the same. The respondent's position is rejected and its exception denied.

As stated above we shall calculate pro forma interest in the traditional manner.

5. *Taxes Other than Income*

We believe that the ALJ's recitation at p. 55 of the recommended decision adequately summarizes respondent's claim for taxes, other than income taxes. The ALJ's recitation is as follows:

"Duquesne's taxes, other than income taxes, for the estimated twelve months ended December 31, 1982, amount to $62,424,000. For rate-making purposes, the amount of FICA tax expense was adjusted by $711,081 and $539,138 to reflect an annualization of the January 1, 1981, increase in the employee's Social Security base from $29,700 to $32,400 as well as the increased rate from 6.65 per cent to 6.67 per cent. The company also adjusted the budget amount for the PUC general assessment to reflect the commission's and consumer advocate's latest assessments. Duquesne adjusted its Pennsylvania public utility realty, capital stock taxes, and Ohio property taxes applicable to the company's interest in Ohio plant and inventory to reflect current rates and values. The company's Pennsylvania capital stock tax, public utility realty tax, and the gross receipts tax expenses were eliminated to the extent that such expenses are recaptured through the state tax adjustment surcharge and net energy clause. Duquesne's tax expenses were increased [to] relfect [sic] an increase

in the gross receipts tax on the additional revenues due to the application of Tariff No. 15 rates for a full twelve months."

After noting that evidence contesting these claims was not submitted by any party, the ALJ recommended approval of the respondent's claim. We find the claim reasonable and shall adopt the ALJ's recommendation, except to the extent that the claim is dependent upon and will be affected by the operating revenue allowance permitted herein.

V. *Rate of Return*

Duquesne, as a public utility, is entitled to an opportunity to earn a fair rate of return on the fair value of its property. Pennsylvania Gas & Water Co. v Pennsylvania Pub. Utility Commission (1975) 19 Pa Cmwlth 214, 11 PUR4th 38, 341 A2d 239; Keystone Water Co. v Pennsylvania Pub. Utility Commission (1975) 19 Pa Cmwlth 293, 302, 330 A2d 873, 877; Riverton Consolidated Water Co. v Pennsylvania Pub. Utility Commission (1958) 186 Pa Super Ct 1, 24 PUR3d 9, 140 A2d 114. Rate of return can be defined as:

". . . the amount of money a utility earns, over and above operating expenses, depreciation expense, and taxes, expressed as a percentage of the legally established net valuation of utility property, the rate base. Included in the 'return' are interest on long-term debt, dividends on preferred stock, and earnings on common equity. In other words, the return is the money earned from operations which is available for distribution among various classes of contributors of money capital." *"Public Utility Economics,"* Paul J. Garfield and Wallace F. Lovejoy (1964), at p. 116.

The return authorized must not be confiscatory, and must be based upon the evidence presented. City of Pittsburgh v Pennsylvania Pub. Utility Commission (1949) 165 Pa Super Ct 519, 82 PUR NS 572, 69 A2d 844.

Although it is acknowledged that the fair rate of return and cost of capital are not always synonymous, we consider the cost of capital to be one of the important bases upon which a fair rate of return is determined. Lower Paxton Township v Pennsylvania Pub. Utility Commission (1974) 13 Pa Cmwlth 135, 317 A2d 917; Pennsylvania Pub. Utility Commission v Duquesne Light Co. R-80011069, Feb. 20, 1981. In availing ourselves of this generally accepted method of arriving at a fair rate of return, we first determine the sources of utility's capital. We then determine the cost of each component; namely, the cost of debt, the cost of preferred stock, and the cost of common stock (common equity). The latter being determined by the return required to sell such stock upon reasonable terms in the market. Pennsylvania Pub. Utility Commission v Pennsylvania Power Co. R-811510 Jan. 22, 1982.

Regardless of the procedure employed in determining fair rate of return, we must exercise "informed judgement." As we stated in Pennsylvania Power:

"The return finding should consider the financial costs being incurred, so that the utility has the opportunity to recover its present cost of capital or to attract needed capital at reasonable cost. A fair rate of return for a public utility, however, is not a matter which is to be determined by the application of a mathematical formula. *It requires the exercise of informed judgement* based upon an evaluation of the particular facts presented in

each proceeding. There is no one precise answer to the question as to what constitutes proper rate of return. The interests of the company and its investors are to be considered along with those of the customers, all to the end of assuring adequate service to the public at the least cost, while at the same time maintaining the financial integrity of the utility involved." (Emphasis supplied.)

Moreover, we must adhere to the legal constraints which guide our decision.

In the landmark case of Bluefield Water Works & Improv. Co. v West Virginia Pub. Service Commission, 262 US 679, PUR1923D 11, 67 L Ed 1176, 43 S Ct 675, the United States Supreme Court addressed the issue of fair rate of return for a public utility. In Bluefield, the court stated:

"What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgement, having regard to all relevant facts. A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country in investments in other business undertakings which are attended by corresponding risk and uncertainities [sic]; but it has no constitutional rights to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate under efficient and economical management, to maintain and support its credit and enable it to raise

the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time, and become too high or too low by changes affecting opportunities for investment, the money market, and business generally." Id., 262 US at pp. 692, 693.

In establishing the standards to be applied in implementing the federal Natural Gas Act, the United States Supreme Court, in Federal Power Commission v Hope Nat. Gas Co. (1944) 320 US 591, 51 PUR NS at pp. 200, 201, 88 L Ed 333, 64 S Ct 281, said:

"The rate-making process, under the act—i.e., the fixing of 'just and reasonable' rates—involves a balancing of the investor and the consumer interest. . . . [R]egulation does not ensure that the business shall produce net revenues. [Citations omitted.]

"But such considerations aside, the investor interest has legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include services on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. The return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital." Id., 320 US at p. 603.

As noted in these cases, we are required to approve as just and reasonable, rates which will produce revenues sufficient to enable the utility to recover all reasonable operating and maintenance expenses, depreciation, and

taxes. Additionally, the utility is entitled to have an opportunity to earn a fair rate of return on the capital invested in the enterprise. Pennsylvania Pub. Utility Commission v North Penn Gas Co. R-80111375, Dec. 9, 1981. We stated in Pennsylvania Pub. Utility Commission v Philadelphia Electric Co. R.I.D. 438, Feb. 5, 1979:

"Among the factors to be considered in determining a fair return are (1) the earnings which are necessary to assure confidence in the financial integrity of the utility and to maintain its credit standing; (2) the payment of dividends and interest; and (3) the amount of the investment, the size and nature of the utility, its business and financial risks, and the circumstances attending its origin, development, and operation."

Finally we must engage in an appropriate balancing of the rates charged to the customers, for the service provided, with the return to which investors in the enterprise are entitled to have an opportunity to earn.

A. *Capital Structure*

The capital structures proposed by Duquesne, the OCA, and staff are set forth below:

Type of Capital	*Duquesne Light Per Cent*	*OCA Per Cent*	*Trial Staff Per Cent*
Debt	51.5	51.47	51.5
Preferred and Preference Stock	13.4	13.45	13.4
Common Equity	35.1	35.0	35.1
	100.0	100.0	100.0

Staff's proposed capital structure is identical, and the OCA's ratios are not materially different, from those proposed by the respondent's rate of return witness, Joseph F. Brennan.

The ALJ recommended adoption of Duquesne's proposed capital structure. No party has excepted. We find that the recommended capital structure is reasonable and adopt it for this proceeding.

B. *Cost of Debt*

Duquesne's rate of return witness, Mr. Brennan, initially estimated the composite cost of long-term debt, as of December 31, 1982, to be 9.44 per cent, under the assumption that the planned April, 1982, sale of $65 million of first mortgage bonds would carry an interest rate of 16.50 per cent. Duquesne states that these first mortgage bonds actually sold at a rate of 16.25 per cent, not the 16.50 per cent originally estimated by Mr. Brennan. Staff's rate of return witness, Kenneth J. Schiavo, included in his calculations of respondent's embedded cost of debt, the lower actual interest expense associated with this first mortgage bond issuance. Both parties now agree that a cost of 9.42 per cent accurately reflects Duquesne's embedded cost of debt.

The ALJ has concluded that the respondent's estimate reflects the latest actual experienced embedded cost of debt and recommended that it be used. No exceptions have been filed by any party.

We conclude that 9.42 per cent is a reasonable composite debt cost rate and we adopted it for use in this proceeding.

C. *Cost of Preferred and Preference Stock*

For preferred and preference stock, Duquesne estimated a composite embedded cost rate of 8.41 per cent as of December 31, 1982. The 8.41 per cent cost rate reflects the planned $25 million sale of preference stock which Duquesne has assumed will have an effective cost

rate of 16.16 per cent. While the OCA has adopted the respondent's recommendation, staff contended that a reasonable cost rate for preferred and preference stock is 8.33 per cent, which was based on an assumed 15.15 per cent effective cost rate for the planned $25 million sale of preference stock.

The ALJ considered staff's estimate to appropriately reflect the recent decline in the prime rate and money market rates and, accordingly, recommended 8.33 per cent as the effective cost rate for preferred and preference stock. No exceptions have been filed by any party. Finding it reasonable, we adopt the ALJ's recommended 8.33 per cent cost rate.

D. *Cost of Common Equity*

When addressing the issue of equity returns, we have come to expect a wide range of cost estimates. Therefore, the controversy which surrounds the determination of the cost of common equity in this proceeding is to be expected.

The respondent's witness, Mr. Brennan, recommended, as reasonable, a common equity cost rate of 18 per cent. Mr. Brennan's recommendation is based upon a discounted cash-flow (DCF) calculation of 16.7 per cent and a refined bare-rent calculation of 17 per cent, which when weighted equally produces 16.9 per cent. This figure of 16.9 per cent was then adjusted to a rate which would be sufficient to permit the respondent's stock to trade at approximately 103 per cent to 110 per cent of book value, a level deemed reasonable by the witness. This adjustment to respondent's recommended DCF calculation produced a final DCF range of 17.4 per cent to 18.6 per cent. The witness has selected the midpoint of this range as his recommended cost of common equity.

The OCA witness, Mr. Rothschild, recommended in his original prepared testimony a 15.25 per cent return on common equity. This equity return rate was the midpoint of his DCF and capital earnings pricing technique (CEPT) findings. At the hearing on October 7, 1982, Mr. Rothschild stated that as of that date he would revise his recommendation downward to a range of 14.5 per cent to 15 per cent to reflect current market conditions.

Originally, staff witness, Mr. Schiavo, recommended a 16.4 per cent return on common equity. After considering recent market data and his judgement regarding the near-term trend for money market rates and the price of Duquesne's stock, Mr. Schiavo concluded, at the September 16, 1982, hearing, that 15.8 per cent would best approximate Duquesne's prospective cost of common equity. In arriving at this equity return of 15.8 per cent, Mr. Schiavo relied upon the DCF and capital asset pricing model (CAPM) methodologies. Mr. Schiavo applied these methodologies to Duquesne and a barometer group of four electric utilities. For Duquesne, Mr. Schiavo's DCF computation yielded a 15.5 per cent cost of common equity while the CAPM yielded 15.6 per cent. Mr. Schiavo selected the rounded midpoint of these two methodologies to arrive at 15.6 per cent. Mr. Schiavo's application of both the DCF and the CAPM methods, to the barometer group, yielded a cost rate of 15.9 per cent. Mr. Schiavo's overall average cost rate for common equity (15.8 per cent) was computed by taking the rounded midpoint of the above mentioned averages of 15.6 per cent and 15.9 per cent.

1. *Discounted Cash Flow*

The DCF analysis is a market-based technique which is founded upon the principle that the amount an

investor will pay for a share of common stock is based upon the present value of anticipated future dividends and appreciation in market price. Pennsylvania Pub. Utility Commission v Dauphin Consol. Water Supply Co. R-80061242, April 3, 1981; Pennsylvania Pub. Utility Commission v Pennsylvania Power Co. R-811510, Jan. 22, 1982. In theory, the DCF method analyzes what an investor expects to receive as opposed to what an investor would like to receive as a return on the investment made.

The DCF methodology is not without its infirmities. The market price of a stock reflects both the current and future investor expectations regarding growth in earnings and hence dividends. Therefore, a separate consideration of growth rates, either in earnings, dividends, or book value reflective of earnings retention, could result in the duplication of a growth estimate which is already reflected, in part at least, in market price. Moreover, normally, market price will also reflect present inflation and an assumption of future inflation. Pennsylvania Pub. Utility Commission v Pennsylvania Power Co. R-811510.

Duquesne's witness, Mr. Brennan, arrived at a common equity cost rate of 16.7 per cent (before adjustment for market pressure and issuance expenses) using the DCF method. Based on an observable recent trend indicating a four cents a year increase in Duquesne's annual dividend, Mr. Brennan assumed the current annual dividend per share of $1.90 would increase by 2 per cent to $1.94. Utilizing an annual dividend of $1.94 and the then current price of common stock of $13.25 (April 8, 1982) witness Brennan calculated a dividend yield of 14.6 per cent. A dividend yield of 15 per cent was then calculated by using the average dividend yield for the

twelve months ending March 31, 1982, while retaining the 2 per cent dividend growth factor. A dividend yield of 14.8 per cent was calculated by Mr. Brennan by averaging the dividend yields of 14.6 per cent and 15 per cent.

Mr. Brennan then removed the 2 per cent, dividend growth assumption and calculated a dividend yield of 14.5 per cent by averaging the 14.7 per cent average dividend yield for the twelve months ending March 31, 1982, and a 14.3 per cent dividend yield based upon a spot price at April 8, 1982. Averaging the 14.8 per cent derived above with the 14.5 per cent derived here, Mr. Brennan arrived at the 14.7 per cent dividend yield to be utilized in his DCF computation.

A growth factor for the DCF formula, of 2 per cent, was determined by Mr. Brennan on the basis of forecasted dividend and earnings growth rates. By combining the average dividend yield of 14.7 per cent and the growth rate of 2 per cent, Mr. Brennan arrives at his unadjusted, DCF-derived, common equity cost rate of 16.7 per cent.

The staff presented a DCF analysis which resulted in a 15.5 per cent cost of common equity. Staff's witness, Mr. Schiavo, calculated a 13.5 per cent dividend yield based upon a $14.125 market price for Duquesne's stock on September 10, 1982, and the current $1.90 per year dividend. The staff asserts that the use of the $14.125 market price represents Mr. Schiavo's best judgement as to the mean or average price for Duquesne stock during the near-term future. In addition, the market price also represents the effect that the drop in money market rates has had on electric utility stock prices. Mr. Schiavo used a 2 per cent growth factor after con-

sidering the historic 1975-82 compound growth rate in dividends per share for Duquesne, the Value Line 1979-81 to 1985-87 dividend rate estimate, and Salomon Brothers' predicted dividend per share over the next full year. Mr. Schiavo's representative dividend yield of 13.5 per cent and his 2 per cent prospective growth rate yielded a DCF-indicated rate of 15.5 per cent. The staff also stated that had Mr. Schiavo used a $1.94 projected dividend per share instead of the $1.90 current dividend per share, the return on common equity for Duquesne would be 15.7 per cent. The staff notes that both results are within the 15.8 per cent common equity cost rate recommended by Mr. Schiavo.

The OCA witness, Mr. Rothschild, recommended a common equity cost rate within the range of 13.9 per cent to 14.4 per cent, based upon the application of the DCF method to the Moody's 24 Public Utilities (before adjustment for financing costs and risk differential). Mr. Rothschild determined that a dividend yield of 12 per cent and growth rates ranging from 1.9 per cent to 2.4 per cent were reasonable. After the adjustments were made for financing costs and market pressure (0.3 per cent), and capital structure risk differential (0.3 per cent), Mr. Rothschild recommended a range of 14.5 per cent to 15 per cent for a DCF-based cost of common equity rate.

2. *Risk Spread Analysis*

Mr. Brennan considered his risk spread analysis to be a refinement of the bare-rent approach. The bare rent theory states that there are three costs to an equity investment, (1) bare rent or the basic time cost (value) of money; (2) an inflation factor; and, (3) the risk element (equity risk premium) to reflect the degree of

risk inherent in the difference between a low risk, near guaranteed obligation, such as a utility long-term debt investment, and a utility common stock investment.

Mr. Brennan's methodology is based on the premise that there is a risk spread between the cost rate for bonds and the cost rate for common equity capital. By combining an estimated 15 per cent cost rate for A-rated bonds as of December 31, 1982, and a 2 per cent risk spread between bonds and common equity capital, Mr. Brennan proposes a cost rate for common equity capital of 17 per cent, before selling and issuance expenses.

3. *Capital Asset Pricing Model (CAPM)*

Staff presented a capital asset pricing model (CAPM) analysis. The CAPM is based on the principal that the cost of common equity is equal to the risk-free cost of capital plus a market premium for the risk associated with the particular stock under study. Mr. Schiavo used the average of recent yields and future prices on three-month Treasury bills for the risk-free rate. Mr. Schiavo used three-month Treasury bills because of his belief that they possess the three important characteristics required of a riskless asset:

(1) the rates are market determined,

(2) the risk of default is minimal, and

(3) the term to maturity is relatively short to minimize the risk of price change and capital loss. The data yielded a current risk-free rate of 11.905 per cent.

Mr. Schiavo calculated the relative market premium for the stock under study by multiplying its beta (0.55) times the equity risk premium for the market as a whole. A 6.733 per cent equity risk premium was

developed by Mr. Schiavo by averaging the differences between Standard & Poor's (S&P) 399 expected DCF returns on equity and three-month Treasury bills over an 11-year period, 1969 through 1979. Mr. Schiavo's alternative of the Dow-Jones 29 data produces an equity risk premium of 6.571 per cent. In order to develop an appropriate cost of common equity under this methodology, Mr. Schiavo, multiplied his risk premiums 6.733 per cent and 6.571 per cent by the beta factor of 0.55. These results, when added to Mr. Schiavo's risk-free rate of 11.905 per cent yields his common equity cost rates of 15.61 per cent and 15.52 per cent, respectively. Applying the CAPM technique to Mr. Schiavo's barometer group (of four electrics) produced common equity cost rates of 15.95 per cent and 15.85 per cent, respectively.

4. *Comparable Earnings Pricing Technique (CEPT)*

The OCA witness, Mr. Rothschild, also used a comparable earnings pricing technique (CEPT) to calculate the cost of common equity. Mr. Rothschild states that this method is based upon an observable phenomenon in the marketplace which is "that the market-to-book ratio achieved by a company is a function of the return on equity a company will be able to earn in the future." Mr. Rothschild ascertained that the return achieved and earned by companies with a market-to-book ratio of 1.00 varied within the range of 13.12 per cent to 13.89 per cent. Mr. Rothschild had used a data base consisting of the S&P 500 plus 400 other companies believed by S&P to be of high investor interest.

After considering that the earned return on equity for industrial companies is less stable than for utilities, Mr. Rothschild normalized the industrial-based data and

proposed a cost of equity of approximately 15.5 per cent. However, Mr. Rothschild concluded that "the CEPT results should indicate a higher than appropriate level for the costs of equity of an electric utility."

E. *ALJ's Recommendation and Exceptions*

1. *DCF Method*

In arriving at an appropriate cost rate for common equity, the ALJ averaged the results of his recommended cost rates for both the DCF and risk spread methodologies.

Based on the DCF methodology, the ALJ recommended the use of a 16.25 per cent cost rate for common equity. This cost rate reflects the use of a dividend yield of 14.25 per cent and 2 per cent growth rate used by both Duquesne and the staff.

The respondent, staff, and the OCA have all excepted to the ALJ's recommendation.

Duquesne argues that the ALJ has failed to update his growth rate estimate of 2 per cent to reflect the investors' increasing growth rate expectations. Duquesne explains that the rise in investor expectations is due to increased stock market prices and reduced current spot dividend yields. Duquesne contends that current financial estimates indicate growth rates as high as 5 per cent.

The staff takes exception to the ALJ's use of an average of the average dividend yield for the 52-week period *ended March 31, 1982*, and the September 10, 1982, projected dividend yield. The staff argues that a consistent analysis would use the average of the average dividend yield for the 52-week period *ended September 10, 1982*, and the September 10, 1982, projected

dividend yields, since this was the date for which the projected dividend yield was derived. The use of a 52-week average dividend yield at September 10, 1982, produces a 16 per cent DCF common equity cost rate.

2. *Risk Spread*

The ALJ also developed a common equity cost rate using the risk spread methodology. Based on this method, the ALJ recommended the use of a 16.2 per cent cost rate. This cost of common equity reflects the use of a debt cost rate of 14.02 per cent and a 2 per cent common equity risk premium.

The ALJ agreed with the bond cost rate of 15 per cent, used by Duquesne witness Brennan, but did not consider his debt cost to accurately reflect current market conditions. However, after recognizing the "hazards of undue reliance on spot price data," the ALJ gave Mr. Brennan's estimate equal weight with more recent data indicating that A-rate bonds have produced yields of 13.04 per cent. (*Wall Street Journal,* November 9, 1982, p. 45). The ALJ's average of the historical (15 per cent) and recent (13.04 per cent) data results in debt cost rate of 14.02 per cent. Finally, the ALJ used the 2 per cent common equity risk premium proposed by Mr. Brennan, which he considered to be the best estimate of that factor on the record and arrived at his 16.02 per cent result.

The respondent excepts to the ALJ's risk spread analysis because it allegedly overlooks the relationships between the spread and the cost of debt. The respondent contends that the ALJ has understated the risk spread cost of common equity by his failure to adjust the risk spread upward to reflect a decrease in his estimated cost rate for A-rated bonds.

Staff argues, in its exceptions, that there is no evidence that bond rates will, in the near-term future, return to the higher 15 per cent cost rates estimated by Mr. Brennan. Therefore, staff contends that Mr. Brennan's erroneous estimate is entitled to no weight and the risk spread analysis supports a common equity cost rate for Duquesne of no more than 15.5 per cent.

The average of the cost rates using the ALJ's DCF analysis (16.25 per cent) and risk spread analysis (16.02 per cent) results in the common equity cost rate of 16.14 per cent recommended by the ALJ. Furthermore, the ALJ agreed with the staff that the market price of a stock fully reflects selling and issuance expenses and underwriting discounts and commissions.

The respondent excepts to this conclusion asserting that the commission has recognized in Pennsylvania Power, R-811510 that issuance costs do exist. Therefore, respondent argues that since they exist an allowance must be made for them and the only way respondent can recover market pressure and selling and issuance expenses is by their inclusion in the cost rate for common equity.

Staff has also excepted to the ALJ's failure to rely on Mr. Schiavo's CAPM cost of common equity analysis. The OCA's exceptions argue that the ALJ's recommended cost rate for common equity of 16.14 per cent is "overly generous to utility equity holders at the expense of Duquesne's hard-hit consumers of all classes."

F. *Conclusion*

Before commencing our analysis of the various allowances urged by the parties, it is worthwhile to reiterate our goal, which is to be fair to the stockholders, and fair to the ratepayers, and to achieve proper balance between these two conflicting interests.

1. *Discounted Cash Flow*

A DCF analysis is based upon two component parts: dividend yield and an investor-expected long-term dividend growth rate. A dividend yield calculation, being a function of the dividend declared by a utility and the market price of that stock, may be influenced by a variety of factors. As the dividend paid by a utility is not subject to daily fluctuations, the selection of an appropriate market price is of prime importance. Pennsylvania Pub. Utility Commission v Philadelphia Electric Co. R-811626, May 21, 1982.

The respondent's witness, Mr. Brennan, calculated a dividend yield based on equal weighting of dividend yield at April 8, 1982, and the average dividend yield for the twelve months ending March 31, 1982. We consider this data dated and therefore of questionable value. The market price data utilized by Mr. Brennan is not representative of the current market price of Duquesne stock. The ALJ concluded that Mr. Brennan's selection of market prices did not reflect the substantial decrease in money market rates and the increase in electric utility stock prices since August, 1982. We agree with the ALJ that the dividend yield employed in this proceeding should reflect more current market data.

The respondent has also misinterpreted our decision in Re Philadelphia Electric Co. R-811719, and ascribed to it a precedential value which it does not have. Based on the record *in that* proceeding, we utilized a 52-week market price average instead of spot data in calculating an appropriate dividend yield. However, we were not following an "established" commission policy in making that determination. There we considered the spot stock

price too low to be an adequate indicator of the prospective market price level. In that case, as has been our practice in determining the cost of common equity, we made an individual analysis in arriving at our conclusion. Here, the sharp decline in the prime lending and other money market rates is a factor which cannot be ignored, and an identical analysis methodology does not appear to be appropriate here. Our comments would be incomplete if we did not also state, that in some instances, reliance on spot data may produce results which have only short-term validity.

In order to insulate his DCF analysis from short-term economic situations, the ALJ also utilized a 52-week average dividend yield in his computation. We agree with the ALJ that this average should be employed to mitigate potential abnormalities that strict reliance upon spot data may produce. Pennsylvania Pub. Utility Commission v Pennsylvania Gas & Water Co. (1981) 55 Pa PUC —.

Accordingly, we adopt the ALJ's recommendation that a dividend yield of 14.25 per cent be utilized as the first component in a DCF analysis of the cost of common equity. We conclude that a dividend yield of 14.25 per cent is reflective of the current as well as the longer term dividend yield which is presently a reasonable expectation by investors.

The second component, the growth rate, which was adopted by the ALJ was 2 per cent. We agree that a 2 per cent growth rate is reasonable and represents growth expectations of investors in the near to middle term.

Therefore, we shall adopt for our use in determining an appropriate cost rate for common equity, the

ALJ's recommended 16.25 per cent cost rate based upon the DCF methodology.

2. *Risk Spread Analysis*

We shall also adopt, for our use in determining an appropriate cost rate for common equity, the ALJ's recommended 16.02 per cent cost rate based on the risk spread methodology. The ALJ's debt cost rate of 14.02 per cent, does in our view, correctly reflect current market conditions and recognize the possibility that the current lower rate may only be indicative of short-term economic conditions. We reject the staff's argument that respondent's 15 per cent estimated cost rate for A-rated utility bonds is entitled to no weight in an analysis.

In addition, we agree that the 2 per cent common equity risk premium is the best estimate of that factor on the record. The respondent's argument that the risk premium should be increased to reflect either the decline in dividend yields or bond yields, is rejected as being without foundation in the record.

3. *Capital Asset Pricing Model*

The staff used the average of recent yields and future prices on three-month Treasury bills for its risk-free rate. We reject that conclusion because such short-term obligations are also reflective of extraneous factors such as essentially the spot money supply.

4. *Comparable Earnings Price Technique*

This technique of Mr. Rothschild's is new and novel. It appears to us that the product of this technique is a stated earnings rate which will enable common equity to sell at book value. Since we do not consider such a result the objective of our search, we do not perceive that the result of this analysis is of any value to us here.

5. *Conclusion*

Based upon our analysis of the various common equity cost rate methodologies recommended by the parties and the ALJ in this proceeding, we conclude that the *midpoint* of the results of the ALJ's DCF analysis (16.25 per cent) and ALJ's risk spread analysis (16.02 per cent) is an appropriate cost of common equity to adopt in this proceeding. Accordingly, we shall utilize 16.14 per cent as our cost of common equity, which, combined with our findings capital structure, cost of debt, and cost of preferred, stock yields an overall return of 11.64 per cent.

Finally, we agree with the ALJ that no special allowance is required for issuance costs. Pennsylvania Pub. Utility Commission v Philadelphia Electric Co. R-811626, May 21, 1982. In Pennsylvania Pub. Utility Commission v Pennsylvania Power Co. R-811510, Jan. 22, 1982, while we concluded that issuance expenses do exist, we also concluded that such costs are reflected in the market price of company's stock. We have not been persuaded here that our position was incorrect.

To the extent inconsistent with our various stated conclusions, the exceptions of the parties are denied.

VI. *Rate Structure*

Witnesses sponsored by the company, the staff, the OCA, the commercial customers, and United States Steel have testified regarding the most appropriate manner of allocating the revenue increase to be granted herein to the various customer classes.

A. *Cost-of-service Study*

A cost-of-service study is a procedure for the allocation of plant investment, revenues, and expenses to

classes of service. Such a study serves as a foundation or beginning point in the determination of just and reasonable rates and consists of three steps: functionalization, classification, and allocation. Functionalization is the separation of plant or costs into the major functions such as power production, transmission, and distribution. The second step, classification, is the separation of plant and costs into categories which recognize service characteristics such as demand, energy consumption, and number of customers. The third and final step, allocation, is the assignment of the functionalized and classified plant and expenses to particular rate classes.

In our opinion and order in Duquesne's last rate proceeding at R-811470, April 19, 1982, we looked closely at the company's cost-of-service study. With respect to the allocation of demand-related production plant, we found that the company's use of the average and excess methodology was reasonable.

With respect to distribution plant and general plant (Accounts 389 to 392 and 397) we directed:

"3. That Duquesne Light Company shall present a definitive study and/or analysis as a substitute for the current assumptions used for distribution accounts in the cost-of-service study in its next general rate increase proceeding.

"4. That Duquesne Light Company shall perform a study reevaluating the current division of General Plant Accounts 389, 390, 391, 392, and 397 between customer and transmission/distribution components by means of a survey and analysis of plant functions in order to ascertain:

"(a) whether the present division is appropriate; and,

"(b) whether the production component in these accounts should be identified as a separate plant function.

"The results of this study shall be presented in Duquesne's next general rate increase proceeding." Id., at p. 34.

In this proceeding, Duquesne presented a complete cost-of-service study. Duquesne witness Richard H. Pierce, vice president of Associated Utility Services, Inc., audited the company's prior cost-of-service methodology, proposed revisions to existing techniques, and assisted in the preparation of the cost analysis for the recorded test-year 1981, under present and proposed rates. The results of Mr. Pierce's analysis and study are contained in Duquesne Exh No. IV, Item IV-C-15. Mr. Pierce made the following revisions to the prior Duquesne cost-of-service study:

1. The demand component of cost utilized for the functionalized distribution plant and the minor amount of transmission plant has been allocated to classes of service on the noncoincident demand method of allocation.

2. Production plant has been classified as demand and energy related.

3. A revised methodology has been utilized for the classification of the demand and customer components of distribution plant and expenses.

4. Certain maintenance costs in the production function have been changed from demand related to energy related.

5. A functional study for each of the general plant accounts has been made for classification and allocation.

6. Each attachment or delivery point from the Duquesne system has been assigned a customer component of cost.

While Duquesne has described these revisions as "minor," they have raised considerable controversy.

1. *Allocation of Demand-related Plant*

Duquesne Exh No. IV, Item No. IV-C-15, contains the fully distributed cost-of-service study summaries. In addition to the average and excess demand, average demand, noncoincident peak, and coincident peak responsibility methodologies required by commission regulations, Duquesne has presented a study which uses the average and excess demand method for plant and expense items functionalized and classified as power supply demand, and the class noncoincident demand methodology for all other demand-related items. Duquesne's position is that the selection of a specific demand cost allocation methodology should be based on the characteristics of the utility and its customers and should include consideration of the following criteria:

(1) The method should recognize kilowatt demand, kilowatt-hour energy consumption and time of use of service.

(2) The method should recognize the characteristics of the various customer class loads supplied by the utility.

(3) The method should produce stable results.

As mentioned above, in this proceeding Duquesne has chosen to allocate power supply demand-related plant and expenses using the average and excess methodology, and to allocate all other demand-related plant and expenses using class noncoincident peak demands.

2. *Classification of Production Plant and Expenses*

Production is one of the main cost functions of any cost-of-service study. Fixed production costs are typically classified as demand-related costs in cost-of-service studies. After analysis, however, Mr. Pierce concluded that certain of the company's production plant and expenses should be classified as, and allocated on, an energy, rather than a demand basis. The vast majority of production plant and expenses (92 per cent) was classified as, and allocated on, a demand basis.

Because of its high daily and annual load factor, its relatively small summer-winter peak differential, and its customer mix, Duquesne chose to allocate demand-related production plant and expenses using the average and excess methodology. The average and excess method of demand cost allocation distributes a portion of total demand responsibility according to the average demand of each class of service. The average and excess demand method was described in Duquesne Exh No. IV as follows:

"*Average and Excess Demand Method*

"The average and excess demand method allocates demand costs in a two-part formula. A portion of demand costs is allocated based on the average demands of the classes. The remaining demand costs are allocated based on the excess of class maximum demands over class average demand. This method has the advantage of recognizing the impact on costs of both energy consumption and maximum demand. By considering both energy and demand, the importance of class load factor, or relative use of facilities, is incorporated into the study. Diversity is also considered with the benefit of diversity allocated on the basis of load

factor. The low load factor customers receive a greater proportion of the benefits of diversity. One of the most important advantages of this method is that stable results are produced. This is particularly critical on a system such as Duquesne's, where one or more customers with extremely large loads can drastically affect the system peak at any time. In the average and excess method the loads composing the system peak are not considered, but class peaks, which are generally more stable, are used. It is Duquesne's opinion that the average and excess demand method meets more of the selection criteria than other available methods and, therefore, is the method most appropriate for Duquesne's system for power production and transmission plant."

In support of the reasonableness of the average and excess methodology as the method of allocating demand-related production plant and expenses, Duquesne states that the important factor to remember is that, unlike peak demand methodologies, the average and excess method, as its descriptive name indicates, allocates a portion of total demand responsibility on an average demand or energy basis, thereby reducing the totality of costs allocated on a demand, as opposed to an energy, basis. Duquesne also states that the commission has expressed a preference for demand allocation methodologies which give some recognition to average demand as compared with those methodologies which rely solely on peak demand allocators, and that its average and excess demand methodology was considered and approved in its last two rate proceedings at R-80011069 and R-811470.

Although the OCA uses the term "peak and average demand" in describing Dr. Stutz's method, his method is, in reality, the average and excess methodology

using the peak demand method to allocate the excess demand as contrasted with noncoincident demand method used by Mr. Pierce for Duquesne. The OCA's position is that only by using the coincident peak method of allocating excess demand "can the actual diversity of the system be accurately reflected and properly allocated."

We perceive no dispute between Duquesne and the OCA that, by allocating average demand upon an energy basis, diversity is at least partially recognized. The OCA witness proposes that the excess demand be allocated on the coincident peak method in order to further and more accurately recognize diversity. On the other hand, Mr. Pierce selected the noncoincident peak method to measure the *use* each class member made of the remainder of production plant.

In our view, the selection of the *appropriate* cost allocation method is largely a matter of judgement rather than a matter of right or wrong or a correct or incorrect methodology. Apparently, while recognizing that the method allocated by Duquesne recognizes diversity, in the view of the OCA, the method advocated by Dr. Stutz more equitably allocates "the benefits of diversity to those classes who create them."

The ALJ recommended adoption of the company's methodology, relying, in large part, upon our action and comments in our opinion and order in the prior Duquesne proceeding at R-811470, April 15, 1982.

The OCA has excepted. In its exceptions the OCA, in arguing in favor of the peak and average methodology of its witness, Stutz, and against the average and excess methodology used by the company, characterized the company's method as having "no contact with

the realities of Duquesne's system planning nor the actual cost incurrance [sic] on its system" and that it "fails to properly reflect diversity on its system and penalizes low load factor customers." Further, that "the record offers no support for the contention that the average and excess method is necessary for rate stability." In conclusion, the OCA offers the fact that its proposed peak and average method has been adopted in New Jersey, North Carolina, and Texas and should be adopted by us.

We shall address this and all other exceptions to the ALJ's recommended decision in our conclusionary paragraph.

3. *Energy-related Production Plant and Expenses*

In Duquesne's cost-of-service study in this proceeding, all generating facilities were functionalized to the production function. Within the production function, however, fuel-handling facilities included within production plant accounts, frequently treated as demand related, were classified as energy related. In support of the classification of fuel-handling facilities as energy related and allocating them on that basis, Mr. Pierce offered the following rationale:

" . . consider two coal-burning utilities. One has a unit coal train to deliver the coal and the other purchases the coal delivered to the yard. The cost of the coal at the mine may be the same to both utilities. The utility that purchases the coal at the yard will have a higher energy cost because of transportation than the utility that owned the unit coal train. Correct classification of the unit coal train is to the energy component of cost not the fixed component of cost. This type of philosophy is required of plant and expense items in order to

assign them in a cost causative manner to match system characteristics and is superior to assigning all fixed costs to the demand component of cost."

In this proceeding, the classification of fuel-handling equipment as energy related, instead of demand related, involves $99,997,063 or 8 per cent of total production plant. This classification requires large energy users to bear a higher portion of the total costs than would be the case if fuel-handling equipment had been classified as demand related.

The commercial complainants presented George Gerasimou who testified on rebuttal against this departure from the National Association of Regulatory Utility Commissioners (NARUC) cost-of-service guidelines.

The ALJ recommended approval of the company's classification of fuel-handling equipment. The commercial complainants have excepted.

Mr. Gerasimou also disputed Mr. Pierce's recommended treatment of certain power maintenance expenses as energy related. The particular accounts there at issue are as follows:

Account		*Amount for Current Year 1981*
	Steam Power Generation	
(512)	Maintenance of Boiler Plant	$23,323,720
(513)	Maintenance of Electric Plant	6,781,556
(514)	Maintenance of Miscellaneous Steam Plant	2,487,411
	Nuclear Power Generation	
(529)	Maintenance of Structures	984,750
(530)	Maintenance of Reactor Plant Equipment	2,274,845
(531)	Maintenance of Electric Plant	999,776
(532)	Maintenance of Miscellaneous Nuclear Plant	999,415
	Other Power Generation	
(552)	Maintenance of Structures	118,306
(553)	Maintenance of Generating and Electric Plant	486,024
(554)	Maintenance of Miscellaneous Other Power Generation Plant	109,838

Of the ten accounts listed above, Mr. Gerasimou claims that four are classified as energy related contrary to NARUC recommendations.

The ALJ concluded, after review of the applicable parts of NARUC cost-of-service manual, that it appeared that of the $38,560,641 which the commercial complainants claimed had been misallocated, some $36,861,723 had, in fact, been classified in accordance with the NARUC manual. Of the four accounts which are classified as demand related by NARUC (Accounts 529, 552 to 554), the ALJ concluded that Duquesne made a reasonable case to the effect that these accounts are, in fact, energy related and should be classified as such. Consequently, he recommended approval of such classification.

The commercial complainants have excepted.

4. *Allocation of Distribution Plant*

In Duquesne's 1980 cost-of-service study submitted in the prior proceeding at R-811470, the company estimated that the 28.8 per cent of distribution plant was customer related. In our opinion and order therein, we directed that:

"3. That Duquesne Light Company shall present a definitive study and/or analysis as a substitute for the current assumptions used for distribution accounts in the cost-of-service study in its next general rate increase proceeding." Id. at p. 34.

In compliance with our opinion and order, Duquesne, through Mr. Pierce, sponsored a distribution plant classification study in which each of the distribution plant accounts was analyzed to determine the portion appropriately to be classified as customer related. The previously employed customer-related assumption for certain distribution plant accounts was replaced with a mathematical model based on the cost of labor to install the distribution system. The results of this study were incorporated into Duquesne's 1981 cost-of-service study. Using the mathematical model, the customer component was determined to be 34.3 per cent of distribution plant, while in the 1980 cost-of-service study only 28.8 per cent of distribution plant was estimated to be customer related. For the residential class the effect of this new customer component, because of changes in numbers of customers and other changes in classification, is to reduce its assignment of *total* distribution plant by 0.8 per cent from the 1980 study to 43.5 per cent currently.

It is Duquesne's position that since the zero intercept method of determining the customer component, which had long acceptance as a methodology until it began producing aberrant results because of inflation, basically represented the labor costs of installing the distribution system, it is appropriate to develop a computerized formula to determine the labor costs attributable to various distribution plant accounts. According to Duquesne, this methodology, is essentially nothing more than a modified zero intercept methodology. Duquesne's witness Pierce used this method to determine the customer component for Accounts 364 through 369.

The commercial complainants opposed this procedure on the basis that it only includes labor costs in the customer component and excludes consideration of any materials. The commercial complainants also argue that this approach is not recommended by NARUC. The company responds that modification of the zero in-

tercept methodology is necessary because, as a result of a decade of inflation, the zero intercept method results have moved into a negative position. The company also asserts that this methodology is entirely consistent with the spirit of the NARUC manual.

The OCA witness, Dr. Stutz, while acknowledging that the distribution system is constructed in response to two primary requirements—the need to serve customer's peak demands and the necessity to blanket the service area with conductors to allow connection of customers—enumerated two threshold questions regarding the derivation of a customer component:

"... First, can the costs of the distribution system be meaningfully divided into distinct components related to peak demands on one hand and the need to blanket the service area on the other? Second, if a reasonable method of separating the costs is available, on what basis should one allocate (and ultimately collect) the cost of blanketing?"

According to the OCA, the exercise assumes that costs of a distribution system can be meaningfully divided into distinct components. In the OCA's view, the character of the distribution system belies this assumption. As Dr. Stutz said:

"... The distribution system brings service to individual customers, each of whom: (a) must be connected to the system at his or her geographical position and (b) must be served through a system of sufficient capacity. Each requirement is meaningless without the other. The various techniques which attempt to divide distribution costs (whether those suggested by the NARUC manual or the alternative put forth by Mr. Pierce) suffer from a substantial flaw. They attempt to

attribute costs on the assumption that an imaginary world exists and is populated by customers willing to pay to be connected to an electric system which they do not use."

Thus, according to Dr. Stutz, there can be no meaningful division of these costs into demand and blanket functions since neither function is actually possible without the other. Therefore, he reasons, any such division put forward is, inherently, arbitrary.

In its main brief, the OCA refers to an industry task force which studied electric utility rate design, known as Task Force No. 4, jointly sponsored by the Electric Power Research Institute (EPRI) and the Edison Electric Institute (EEI) among others and performed for NARUC. The OCA states the task force, which consisted of twenty members representing state utility commissions, electric companies, service groups which perform cost-of-service studies for electric utilities, federal regulatory agencies, and EPRI, made two points. First, they noted that there is a substantial disagreement among experts as to what customer costs really are. Secondly, they noted that even where similar definitions of customer costs are adopted cost analysts produce dissimilar results. The task force's final recommendation was that, of the distribution costs, only services and meters should be considered customer related. The OCA further advises us that the task force stated: "By doing this we have eliminated the guess work of allocating certain costs between demand and customer."

The OCA then submits that the costs of blanketing the system cannot be accurately estimated, and that Mr. Pierce's methodology clearly illustrates the validity of the Task Force No. 4 recommendation. In addition it

argues that, even if the costs of blanketing the system could be estimated, his blanketing component is not properly classified as a customer cost and cannot be allocated accurately on the basis of the number of customers.

The OCA also argues that while the blanketing function derives from the need to serve the service area with a distribution system and is a function of the density of customers on the system its costs are not properly considered as customer-related costs.

In conclusion, the OCA argues that the commission must recognize the function of the distribution system and reject Mr. Pierce's "modified" zero or minimum intercept system as a measure of a phantom minimum distribution system that is little more than a theoretical exercise. Likewise it argues that distribution costs cannot be accurately divided into demand and blanketing functions and assuming, arguendo, that they could, the blanketing component of distribution costs cannot be allocated accurately to customer classes on the basis of the number of customers.

The OCA recommends, that in this case, the Task Force No. 4 recommendation be followed, and that mass distribution plant should be classified as entirely demand related.

Duquesne argues in response that the consumer advocate's contention that the separation of a portion of distribution plant into a customer component fails to recognize the function of the distribution system, is wrong. It cites United States Steel witness Lim, who, while recognizing that Mr. Pierce's methodology was not specifically set forth in the NARUC manual, supported Mr. Pierce's modified zero intercept methodology

as being the same conceptual methodology recognized in the NARUC manual, and explained how certain labor-related costs have no relationship to capacity to deliver maximum and lesser demands for electricity. In his view, these costs are appropriately considered as customer-related costs and should be allocated on that basis. As stated in Mr. Lim's direct testimony:

"It takes no extraordinary imagination to acknowledge that costs must be incurred, in planning, constructing, and operating a distribution system, which have no relationship to capacity to deliver maximum and lesser demands for electricity. Typically, they are comprised primarily of labor-related costs, the major component of installing electric distribution plant.

"The engineering cost and effort of completing two distribution system projects, of like configuration but different capacity, are practically the same. Similarly, apart from differences in equipment and facilities ratings and differences in size and weight attributable to such different ratings, the equipment and facilities are much the same and require the same time and man power to install. If overhead, poles must be placed, crossarms, hardware and insulators assembled, wires strung, transformers hung, etc., in a similar manner for both projects. If underground, the pavements and sidewalks must be broken, manholes and trenches dug, conduit laid, cable pulled, fittings installed and wrapped, ground repaired, and many other task [sic] performed which are essential to getting the system in place, without regard to its capacity. All of these activities would be required for each project, to be performed in similar fashion.

"Of course, actual projects are designed and built to particular capacity levels, and cost differences do

exist from differences in size and weight of facilities and machines. It is this type of difference which is measured by various zero intercept methods, whereby the change in cost associated with a change in capacity is determined for particular plant units in order to exclude such costs from the customer cost category. A careful zero intercept analysis, with adequate data and correct choices of increments to measure, provides an objective, reasoned result of what plant cost remains after elimination of that share of costs attributable to capacity characteristics.

"Whether such remaining plant cost is called a 'minimum system'—which seems to trouble Dr. Stutz—or something else such as noncapacity cost component of distribution system, is wholly beside the point. It is necessary to imagine the physical shape and appearance of a system costing the same as the 'minimum system,' because we are interested only in costs, not a hypothetical system. The point is that such costs exist, they can be measured, and they are not occasioned by design requirements for maximum demands.

"Any debate about their merits is properly directed only to how accurately they are determined, not whether they should be determined at all."

Relying in part upon our opinion and order in the Duquesne proceeding at R-811470 he concluded that Duquesne's study here is a reasonable attempt to measure a minimum customer component and recommended its adoption.

The commercial complainants except to the ALJ's approval of Duquesne's methodology; first, because it failed to classify any materials as customer related; and, second because it is not one of the two methods en-

dorsed in the NARUC cost allocation manual as appropriate for the determination of the customer classification of the distribution system.

The OCA excepted to the ALJ's recommendation on the basis that no portion of the distribution system should be classified as customer related with the possible exception of meters and services.

5. *Allocation of General Plant Accounts*

General plant includes all plant used for general purposes and which is not included in the FERC Uniform System of Accounts under production, transmission, or distribution functions.

In the 1980 cost-of-service study presented at R-811470, Duquesne estimated that 50 per cent of General Plant Accounts 389 to 392 and 397 were customer-related investment with the balance being classified in accordance with production, transmission, and distribution plant. Since there was a customer-related plant classification component in the distribution function, the company's prior method of classifying general plant resulted in 55.5 per cent of total general plant being allocated on a customer-related basis. In our opinion and order, at R-811470, we directed the company as follows:

"4. That Duquesne Light Company shall perform a study reevaluating the current division of General Plant Accounts 389, 390, 391, 392, and 397 between customer and transmission/distribution components by means of a survey and analysis of plant functions in order to ascertain:

"(a) Whether the present division is appropriate.

"(b) Whether the production component in these accounts should be identified as a separate plant function.

"The results of this study shall be presented in Duquesne's next general rate increase proceeding." Id. at 34.

In compliance therewith, Duquesne, through Mr. Pierce, presented a general plant functionalization study in which each of the general plant accounts was analyzed to determine the characteristics of the items included in the account. The items in each account were assigned to a functional category such as production, transmission, distribution, or customer accounts. The results of the study indicate that general plant investment is 59.5 per cent demand related, 39.2 per cent customer related, and 0.9 per cent energy related. The corresponding values used in the 1980 cost-of-service study submitted at R-811470 were 44.5 per cent demand related, 55.5 per cent customer related, and zero per cent energy related. The 1981 study results in a significant reduction in the customer component of investment in general plant. The results of the study were incorporated into the 1981 cost-of-service study included in Duquesne Exh No. IV Item IV-C-15.

As a result of the 1981 cost-of-service study, the customer component of general plant was reduced by $7,406,000 in spite of an increase in general plant investment of $10,586,000, with the investment primarily shifted into the demand component. Of the total general plant investment, 44.4 per cent is assigned to the residential class, 52.3 per cent to the general service class, and 3.3 per cent to the streetlighting class. In dollar terms, the residential class assignment of general plant is reduced by $7,396,000, below the 1980 assignment. In turn, the general service class assignment of general plant is increased by $16,937,000 over the 1980 value. A shift in the allocation of general plant from the residential class to the general service class is the result of the reduction in the total amount of investment which is classified as customer related. As explained in Duquesne Exh No. 22B, as more plant investment is classified demand related, the residential allocation decreases and the general service allocation increases.

The OCA states that the company's cost-of-service study move toward a more appropriate classification of these costs and does not argue against its use here. However, the OCA recommends that, even though the company's results not be modified for this case, the commission order Duquesne to continue to review this area, including administrative and general expenses (Accounts 920 to 923) and supervisory and engineering costs (Account 590) along with general plant accounts (Accounts 389 to 399), in a broader context than a strict embedded cost-of-service approach. The OCA would have us order Duquesne, in its next cost-of-service study, to consider this problem by: first, compiling a schedule of costs which are unrelated or only weakly related to one or more of the classification categories; and, second, by providing cost-of-service studies which allocate these costs on the basis of demand and energy.

The ALJ recommended approval of the company's classification methodology and finding no need for additional study rejected the OCA's request for an additional study. The OCA has excepted to the ALJ's recommendation against additional study regarding the appropriate classification of the enumerated areas of investment and expenses. The commercial complainants except to Duquesne's failure to follow NARUC guidelines regarding the classification of these accounts. Having carefully read the OCA request for an additional study regarding the classification of certain accounts, as set

forth in its main brief and the underlying testimony of Dr. Stutz at pp. 25-28 of OCA Statement No. 5, we find ourselves unable to formulate a directive as to how such a study should be performed, with sufficient specificity as to be a meaningful directive. Also, having considered Dr. Stutz's testimony at length, we conclude that any such study would be replete with subjective judgements. Consequently, we decline to direct any additional study.

6. *Conclusion*

In each area of contention regarding Duquesne's cost-of-service study, both as to its basic allocation methodology, by the OCA, and the antecedent classifications and the methodology employed therefore, the ALJ has recommended approval of the company's classifications, their methodology, and the ultimate allocation methodology employed. The OCA and the commercial complainants have excepted extensively and at length on several points. Because of the extent of the exceptions and the detail in which the parties would involve us in responding, details in which we do not believe it either necessary or appropriate to become involved, we feel it appropriate to express our views on the subject of cost-of-service studies in general.

A cost-of-service study is one of the most subjective elements in any rate case. The methods used for classifying items of plant and expense between demand, *customer*, and energy components are far from being an exact science. Cost-of-service studies are more accurately characterized as engineering art.

This commission has historically recognized the cost-of-service study for what it is: a useful tool for testing the reasonableness of the proposed allocation of the revenue requirement. Rarely, if ever, is revenue requirement allocated strictly on the basis of cost-of-service results. In most instances, and this case is no exception, the revenue allocation is based primarily on other factors such as economic impact and rate continuity with some modification due to cost-of-service considerations.

In this proceeding, different aspects of Duquesne's cost-of-service study have been vigorously challenged by the OCA and the commercial complainants. Plausible arguments have been made on both sides of a number of the issues that have been raised. The key question to be answered, however, is whether or not the company's study is, on the whole, acceptable, keeping in mind its limited purpose as a guide to the reasonableness of the revenue allocation.

Our conclusion on the issue of cost of service is that the company's study is generally acceptable in the context of this case. Accordingly, we adopt the various recommendations of the ALJ, and thereby the company's cost-of-service study, and deny the various exceptions of the parties.

B. *Specific Rate Structure Changes*

1. *Duquesne Proposals*

Using the cost-of-service study as a guide, and upon consideration of various other factors, Duquesne proposed the following changes in Tariff No. 15 schedules of rates and changes, and rules:

Rate RS—Residential Service

Unit prices have been increased.

Availability clause modified to clarify meaning.

Late payment charge on disputed bills was modified.

Special provisions revised to include residential garages.

Price differential for water heating block revised.

Rate RH—Residential Service Heating
Unit prices have been increased.
Availability clause modified to clarify meaning.
Late payment clause modified to clarify meaning.
Special provision revised to include residential garages.
Reference to months billed revised.
Price differential for water heating block revised.

Rate GS—General Service Small
Unit prices have been increased.

Rate GM—General Service Medium
First and second energy blocks have been combined.
Unit prices have been increased.

Rate GL—General Service Large

Rate GHR—General Service Heating (Restricted)

Rate I—Interruptible Power Service

Rate L—Large Power Service
Unit prices have been increased.

Rate GMH—General Service Medium Heating

Rate GLJ—General Service Large Heating
Unit prices have been increased.
Reference to months billed revised.

Rate SM—Streetlighting Municipal
Unit prices have been increased.
Freeze on installation of mercury vapor streetlighting.

Rate SE—Streetlighting Energy

Rate SH—Streetlighting (Highway)
Surcharge percentage has been increased.

Rate SR—Streetlighting (Restricted)
Surcharge percentage has been increased.

Rider 4—Budget Billing
Made applicable to Rates GM and GL.

Rider 8—Summer Service—Limited
Withdrawn from tariff.

Rider 9—School and Governmental Service
Maximum average charge and minimum charge have been changed resulting in increases.

Rider 10—State Tax Adjustment
Percentage has been increased.

Rider 12—Fuel Cost Adjustment

Rider 13—Emergency Energy Surcharge

Rider 14—Net Energy Clause
Withdrawn from tariff.

Rule 4—Contracts

Rule 5—Deposits and Advance Payments

Rule 8—Connection Charges

Rule 13.1—Underground Distribution
Revised to clarify meaning.

Rule 9—Relocation of Facilities
This rule was formerly Rule 8.1 in Tariff 14 and was revised to clarify meaning. Former Rule 9—distribution within a building from Tariff 14 has been withdrawn from the tariff.

Rule 13.3—Thermal Integrity and Insulation Standards
Temporarily suspended.

Rule 18—Redistribution
A clause encouraging energy conservation added.

Rule 21.2—Return Check Charge

New rule added to charge customer for a check returned to the company unpaid by the customer's bank.

Rule 24—Tampering

Payments shall include interest at the late payment charge rate.

Rule 41—Reconnection Charge

Rule revised and establishes a schedule of reconnection charges.

In summary the company proposed an increase of 24.4 per cent for residential service (RS and RS-WW) customers and 25.5 per cent for residential hearing (RH and RH-WW) customers. Rate GS was proposed to be increased by 27.6 per cent, Rate GM 23.8 per cent, Rate GL 24.6 per cent, Rate GHR 24 per cent, Rate GMH 22.7 per cent, Rule GLH 23.2 per cent, and, Rate L 21.8 per cent. The streetlighting customers would receive an increase ranging from 26.8 per cent (Rate SH) to 73.8 per cent (Rate SR).

The allocation of the operating revenue increases to the rate classes, as proposed in Tariff No. 15, was based on base revenues at zero fuel with each class receiving approximately the same percentage increase. After the operating revenue target had been determined for each rate class, the operating revenue target for each rate schedule within each rate class was established by applying the same percentage increase for each rate schedule. A review of the rate of return of each rate schedule was then made to determine if there were significant differences between the system average rate of return and rate of return from each rate schedule. If a significant difference was found, adjustments were made

to the targeted operating revenue increase in order that rate of return from each rate schedule would be closer to the system average rate of return.

The following adjustments were made by the company to the allocated revenues to bring the rates of return closer to the system average. Three million dollars were removed from the residential class with $2 million being added to Rate 1 in the general service class, $900,000 being added to Rate SE in the streetlighting class, and $100,000 being added to Rate SR also in the streetlighting class. Two million dollars were removed from Rate GM and added to Rate GL, both rates being in the general service class. One hundred thousand dollars were removed from SM and placed in SR, both rates being in the streetlighting class.

Under present rates the total system earns a 10.73 per cent return. Residential customers produce an 11.17 per cent return, Rate Class GS and GM earn 11.33 per cent, Rate GL 10.05 per cent, and Rate L 10.35 per cent.

Under the proposed rates the total system average would be a 15.73 per cent return. Residential classes would produce a 16.24 per cent return, Rate Classes GS and GM 16.18 per cent, Rate GL 14.93 per cent, and Rate L 15.39 per cent.

2. *OCA Proposals*

Dr. Stutz, the OCA witness, proposed that the return from residential customers be limited to 95 per cent of the system average. The basis for this proposal is that in his view Duquesne's industrial customers place a greater risk on Duquesne than do its other customers. Additionally, he proposed that the industrial customers of Duquesne, served under Rates GL and L, be

required to provide at least a system average rate of return.

This recommendation appears to be based on Dr. Stutz's interpretation of the testimony of Joseph Brennan, presented in other proceedings, in other jurisdictions. The company called Mr. Brennan in rebuttal to explain his prior testimony. Mr. Brennan's testimony with respect to the application of the theory of risk differential pricing in this proceeding is especially instructive:

"There is little doubt much more work must go forward before full implementation of tariff design can appropriately reflect rate of return differential by customer class. Moreover, sudden changes in pricing as a result of recognition of a new approach may need to be phased in gradually to minimize undue economic hardship and dislocation. It is possible to price a service so high by comparison with alternative choices as to be counterproductive to the enterprise and all of its customers. For instance, if the cost of electricity to industrial customers would not be competitive, or if the price of service to industrial companies resulted in the loss of the customer of expansion by the customer in the service territory of another electric company, the possible resultant reduction in load factor causing higher residential rates suggests a possible practical limit to the practice of full and immediate reflection of cost-based rate making."

In addition, Mr. Brennan stated:

"Given the apparent sad state of affairs with respect to some large customers served by Duquesne Light Company, it would seem counterproductive to all other customers viewed over the longer term to raise

the rate of return to large customers for pricing purposes certainly at this time as jobs may be lost, the load factor may be reduced, and over time residential rates may be higher than otherwise and my article in the FORTNIGHTLY clearly so indicated."

The ALJ recommended that the OCA proposal be rejected. In addition to the reasons stated above by Mr. Brennan, the ALJ founded his recommendation upon his conclusion that Mr. Stutz made no evaluation of the impact of the ratchet provisions in the tariff or the residential uncollectible factor in assigning risk to the various customer classes. Furthermore, he said, Duquesne's tariffs are not based on customer classes, but rather the size of customer demands, therefore, hospitals and schools, for example, are in the same class as large industrials, and that there would be no way to segregate industrial customers in order to assign them a higher return even if warranted. We agree with the ALJ that this proposal should be rejected. The OCA exception is, accordingly, denied.

OCA witness Stutz also proposed a change in the company's customer charge to reflect costs on a "customer only" basis. Under Dr. Stutz's proposal, the residential customer charge would be reduced from $4.95 per month to $3.92 per month. The company has proposed an increase in this charge to $6.35 monthly. Staff witness Rosenthal also considered this question and proposed that the $4.95 charge remain at its present level.

The company claims that the residential customer charge should reflect all those costs which are customer related and on this basis urges the increase to $6.35.

After reviewing the record, it was the ALJ's conclusion that Mr. Rosenthal's recommendation should be

adopted. He stated that in his view, a monthly customer charge should cover basic customer costs, excluding full consideration of the carrying charges on meters, services, and certain general plant, as well as the operation and maintenance expenses associated with meters, customer installations, meter reading, and customer records. The ALJ was also of the opinion that Mr. Rosenthal's methodology was consistent with our opinion and order in Pennsylvania Pub. Utility Commission v Philadelphia Electric Co. R-811626, May 21, 1982, and should be adopted here. The ALJ concluded, therefore, that any increase in the residential operating revenues was to be derived from increased kilowatt-hours charges. We agree with the ALJ. The residential customer charge shall be retained at its current level. The company's exception is denied.

3. *Staff Proposals*

In addition to its position on customer charges stated above, staff also proposed that the credit per kilowatt on Rider 7—interruptible service, be increased from $2 to $3. Increasing the credit to $3 would require a revenue increase from all other customer classes of $1 million.

Without discussing the merits of staff's proposal, it was the ALJ's view that in light of the economic conditions in the service territory, as evidenced by declining industrial sales and high unemployment rates, this proposal, which would increase the total revenue allowance, as well as the revenue contribution of residential and general service customers, should not be adopted at this time. We agree with the conclusions of the ALJ and, accordingly, the staff's exception is denied.

The staff, noting that Duquesne also proposed a 50 per cent base rate increase for Rate SE and a 73.8 per

cent increase fo. Rate SR, took the position that while these increases may be justified on a cost-of-service basis, any increase to these classes should be limited to 150 per cent of the system average increase.

The ALJ agreed with the staff position. His view was that cost-of-service considerations should be tempered by gradualism and that, as proposed by Duquesne, the revenue impact on these customers—municipalities operating under severe budgetary restrictions—would be substantial. The ALJ stated that the staff's proposal, while moving these customers towards the system average rate of return, recognizes that such a shift must be done without disruptive effects on the public interest. We reach the same conclusion as the ALJ, the increase for the streetlighting classes, individually, shall not exceed 150 per cent of the systemwide increase approved herein. The respondent's exception is accordingly denied.

VII. *Other Issues*

A. *Minimum Performance Standards—Beaver Valley No. 1*

In their main brief the commercial complainants stated that they have consistently opposed the inclusion of Beaver Valley I in rate base, based upon their assertion that the plant was not prepared to provide reliable service, and that history has proven them correct. Further, they state that Duquesne's management and investors have yet to be held to any standards of performance in operating this plant. The commercial complainants then urge that we "impose a requirement that Duquesne operate the plant to meet some minimum level of performance, or else be deprived of its full return on the plant as far as the ratepayers are concerned." Regarding the standards to be established, they state that their

prior suggestion that Duquesne be required to have the plant meet a capacity factor or availability factor of 60 per cent has been rejected as unrealistic. Here they assert "that the commission should, *utilizing its own skills,* establish some minimum level of performance for Duquesne to meet at the Beaver Valley No. 1 plant. The minimum standard should be considered by the commission in this proceeding in affixing (sic) Duquesne's rate of return."

The ALJ did not address this subject in his recommended decision. In their exception the commercial complainants state that they "continue to except to the nonexistance [sic] of any ongoing minimum performance standard to Duquesne should be held with respect to this one plant," asserting that we have the inherent power to set such minimum efficiency standards under the provisions of 66 Pa.C.S. § 1501.

Without engaging in an extensive discussion of the many factual scenarios and considerations, as well as rate-making considerations, which it would be necessary to address in developing an appropriate performance standard, and then to formulate and administer an appropriate sanction for failure to meet the standard, in whole or in part, one must state that we are impressed with the fact that the commercial complainants have suggested neither a specific standard, nor a specific sanction, nor have they suggested how any performance standard which might be adopted would be administered over time.

Having considered this subject we are of the opinion that the record in this proceeding is devoid of any basis upon which to adopt a performance standard with regard to Beaver Valley No. 1. Accordingly, the exception is denied.

B. *Residential Load Research*

The OCA states that, while it did not make any specific recommendations as to altered residential rate blocking, its witness, Dr. Stutz, did testify that the nature of Duquesne's residential load research did not permit the development of *an appropriate, cost-based* blocking structure and charges. It is the OCA's view that Duquesne's load research program does not provide a basis upon which to determine whether flat, inverted, or declining rates are appropriate, based upon the assignment of demand costs. The OCA's position is that Duquesne does not meter a statistically valid sample of individual residential customers and thereby provide a basis for comparison of usage patterns of customers with varying kilowatt-hour usage, but rather merely meters the demand on six test circuits, each serving a number of customers, with a consequent inability to relate individual customers' energy usage to their peak demands. The OCA requested that Duquesne be directed to "perform load research that will allow this commission to properly consider this issue."

The OCA excepts to the ALJ's omission of any discussion of this subject in his recommended decision, stating that the issue had been presented in its *reply* brief. The OCA's exception is essentially a paraphrased repetition of what was stated in its reply brief.

We have previously commented upon the inappropriateness of a party first raising an issue in reply brief. In our opinion and order in the last Duquesne proceeding at R-811470, April 19, 1982, we stated:

"PAJE [Pennsylvania Alliance for Jobs and Energy] proposed for the first time in its reply brief that the amount of $529,202 (total company), which represents

customer deposits, be deducted from rate base. The reply brief of a complainant is a singularly inappropriate place for an adjustment to be first proposed, at a time at which the commission will be denied the benefit of the utility's response. But for the fact that we find other difficulties which we will set forth herein, we would reject the proposed adjustment out of hand, for untimeliness." Id at 14.

But for the fact that Duquesne anticipatorily addressed the subject in its main brief, for which we commend it, we would have no choice but to refuse to address the issue because of the untimeliness of the OCA in addressing the subject for the first time in its reply brief.

Turning to the merits of the OCA's request, we are uninformed regarding the anticipated cost of a metering program such as suggested by the OCA witness. We would speculate, based upon our recollection of the costs for other utilities, that such costs would be in the neighborhood of $500,000 to $1 million for an initial one-year program.

Without going into a detailed analysis, based upon the record before us, we are not satisfied, that a new or expanded residential metering program by Duquesne is either necessary or appropriate. We reject the OCA's request and its exception is denied.

C. *Conservation Program*

The OCA presented a witness, Neil H. Talbot, who presented testimony amounting to a critique of Duquesne's existing conservation programs, and his suggestion for a new and/or expanded program. Mr. Talbot's prepared testimony, OCA Statement No. 4, runs to 70 pages. The ALJ devoted some 13 pages to

the summarization of this issue in his recommended decision, but made no recommendation on the subject. The OCA devotes ten pages in its main brief to the subject, concluding with the injunction that the company's conservation program be expanded into the five programs which it proposed. These were:

1. A more effective residential conservation service program;

2. A refrigerator efficiency rebate program;

3. An air conditioner efficiency rebate program;

4. A wrap-up/turn-down program for water heaters and a seal-up program for dwellings; and,

5. A tariff restriction on electric space heating.[14]

In conjunction with our investigation at I-80100341, we issued an order on August 27, 1982, directing that an investigation be opened for purposes of developing a commission policy, applicable to all electric utilities, whereby regulatory incentives would be afforded to any cost-effective conservation-inducing investment designed to lower a utility's need to install additional capacity.

On September 21, 1982, we issued an order, with an attached proposed policy statement on regulatory treatment of conservation and load management programs, which we directed be published in the *Pennsylvania Bulletin* and served upon all Class A electric utilities subject to regulation by this commission, the Office of Consumer Advocate, and the Governor's Energy Council. All Class A electric utilities were directed to submit comments thereon and all other interested parties were invited to submit comments.

[14]The reader is referred to pp. 58-72 of the ALJ's recommended decision for a detailed summary of these programs.

In light of the ongoing generic investigation we deem it wise to await the outcome of that investigation prior to the adoption of any specific program for a particular utility. Consequently, the OCA's request and its exception is denied.

VIII. *Conclusion*

We have concluded herein that Duquesne is entitled to an opportunity to earn income available for return of $207,112,000 based upon its Pennsylvania jurisdictional operations. This constitutes an increase in operating revenues of approximately $105,850,000 or approximately 64 per cent of the $165 million increase requested. In furtherance of such an objective Duquesne is authorized to establish rates which will produce $802,463,063, annually, in total Pennsylvania jurisdictional operating revenues, in such a manner as is more fully described in the appropriate ordering paragraphs.

SHANAMAN, chairman, dissenting: On April 30, 1982, Duquesne Light Company filed for an electric revenue increase of $165,013,000 annually which represents an increase of approximately 20 per cent.

It should be noted that the company's most recent increase of $64.2 million was finally approved less than one year ago, on April 15, 1982.

I believe the commission's final order, which will allow additional revenues of approximately $105 million, erroneously permits the full recovery of the company's costs associated with canceled CAPCO units, allows the unwarranted expansion of the commission's test-year concept, permits a generous return for the company's shareholders, and fails to flow through the benefits of state income tax deductions to the company's ratepayers. For these reasons, I must dissent.

The commission's decision to permit full cost recovery of the company's investment in four canceled nuclear units is a reversal of established commission policy concerning generating plants which are not considered used and useful. In a 1979 Philadelphia Electric Company case (RID 438) we stated:

"The fact that excessive plant investments were prudent when made does not necessarily preclude the commission from alloting responsibility for their cost."

By permitting full recovery of all costs, the commission has also disregarded the expert opinion of its own trial staff. Trial staff was on target when it stated:

"The courts in this jurisdiction, however, make it clear that public utilities are entitled to a fair return on the fair value of property used and useful in providing service to the public and that only the costs of such used and useful property may be included in rates. The costs of property that never provided service to the public, regardless of prudence, must be excluded from customer rates."

By insulating management from all business risks (while permitting a premium equity return) we are not equitably balancing the interests of ratepayers and stockholders.

The commission has informally considered proposals to expand the current test-year concept to include all expenditures made during the first year rates are in effect. Fortunately, these attempts to expand the future test-year concept have failed. The commission acceptance of *estimated* expenditures for environmental control projects *expected* to be in service during 1983 again violate the principle of allowing only used and useful property in rates. The allowance is based upon com-

pany estimates and expectations which may, in fact, prove to be inaccurate. Any overestimate of costs will be fully assumed by ratepayers, however, thus once again shifting risk from the shareholder to the ratepayer.

Nowhere is the commission's failure to balance the interest of the investor and ratepayer more obvious than in its treatment of state tax reductions. Despite the fact that the company is not required by law to retain use of these funds, the commission concludes that normalization of these taxes "should improve its (the company's) financial position with attendant benefits, not only to investors, but to its customers as well" (Pennsylvania Power Company, R-811510). I suspect that most customers, many of whom are finding it hard to survive in a recessionary economy with high unemployment, would find little solace in the commission's logic. The commission's action is analogous to demanding that hard-pressed ratepayers (many of whom are unemployed) advance a $6 million loan to the company simply to improve its cash flow. If this "loan" is ever repayed by the company, it will be in the form of future dollars which will have lost much of their value due to inflation. Ironically, this improved cash flow comes at the expense of consumers who have a greater need for cash than does the company. Where normalization is required by law it is defensible; the case at hand provides absolutely no justification for such an action.

Despite shifting the risk in several key areas from the company to the ratepayer, the commission would give the company's stockholders an opportunity to earn a return in excess of 16 per cent on their investment. What must be kept in mind is that most interest rates for long-term debt have fallen nearly 5 per cent in the past

year. The prime rate, which was 15.75 per cent one year ago, is now 11 per cent. Thirty-year Treasury bonds, which were at 14.30 per cent, are now 10.6 per cent. Based upon historical trends as well as data contained on the record, the trial staff recommended allowance of 15.8 per cent is quite generous.

Regulation must, by definition, be protective in character. Regulators have a three-fold responsibility; the needs of consumers, investors, and the communities served by the utilities must be balanced. I believe my positions maintain that balance. In times such as these, it is not unreasonable to expect stockholders to assume some of the costs of canceled nuclear units. It is also not unreasonable to flow through tax benefits to the hard-pressed Pittsburgh consumer. These actions, while protecting ratepayers, would still provide the company with the funds necessary to permit investors a reasonable return on that part of their investment serving a public need and to preserve the financial health of the company.

JOHNSON, commission, dissenting: The majority opinion in this proceeding is unjust and unreasonable and does not produce a just and reasonable result.

Construction Work in Progress

The majority's post-test-year recognition of construction work in progress is based on the commission opinion in Pennsylvania Pub. Utility Commission v Philadelphia Electric Co., R-811626. I objected to that opinion, and filed a dissenting opinion. I similarly object to post-future test-year budget projections in this proceeding as the basis for part of the increase in this proceeding.

Cash Working Capital

Inasmuch as the post-test-year nuclear fuel reload scheduled for early 1983 is another out-of-period

speculative adjustment I object to the inclusion in the rate base of $5,848,344 for this purpose and note that I also objected to this matter in the Philadelphia Electric Company case cited above.

As a general proposition I have found that the *actual necessity* for working capital, supplied by investors, in a going concern utility is an illusion.

A demonstration that receipt of revenues lags behind the payment of expenses does not per se demonstrate the actual necessity of the condition which fluctuates both within and among utilities. It is abundantly clear from the rate proceedings before the commission that the utility-proffered analyses do not reflect all available ratepayer-provided sources of working capital such as accrued but unpaid taxes, accrued but unpaid interest on outstanding debt, and accrued but unpaid dividends on preferred stock.

The existence of a lag does not demonstrate the reasonableness of: the terms under which a utility conducts transactions with affiliates; the calculation of payroll lags; the lag in the payment of bills rendered by vendors; the time required to render a bill to its customers at the conclusion of a billing cycle; the time required to post transactions on the company records when payments are made and received; the length of the billing cycles; the credit and collection policies.

There is some sentiment on the commission that the time and effort spent on this subject has been out of proportion to the impact of working capital on rates. I would point out that the time and effort spent by the commission has produced such a wide variety of results that I can hardly believe that the efforts as they are should be continued. But neither can the company claims be accepted.

According to the quarterly reports submitted to the commission the following spectrum of "expense days" have been included in the rates of the major utilities.

	Expense Days		*Expense Days*
Met Ed	zero	Columbia	12.6
Penelec	3.3	Equitable	3.0
West Penn	4.1	National Fuel	2.0
Duquesne Light	17.9	North Penn	20.5
PP&L	22.9	Pa. G&W	5.1
UGI (el.)	30.3	Peoples	5.3
PE Co. (el.)	39.6	PE Co. (gas)	18.3
Pa. Power	59.3	UGI (gas)	14.5

Management policies directly affect working capital and must be considered when arriving at conclusions as to the reasonableness of a particular claim.

Sales to Crucible Steel

I do *not* dissent from the resolution of this issue by the majority. I have chosen to comment here in full support of the language used by the commission in the hope that it was not unintentionally included. I specifically and expressly support the following proposition:

"In examining Duquesne's adjustment methodology, as constrasted [sic] with that of the staff, we find nothing to commend it over the staff's methodology, insofar as validity is concerned, and therefore conclude that Duquesne has failed to meet its burden of proof concerned in this adjustment."

Rate Case Expense

No reason has been provided which has not been previously considered and rejected by this commission for a change from a ten-year amortization to a five-year amortization. I therefore object to the reconsideration of the commission's prior decision on this matter.

Moreover I maintain the strong view that rate case expense is uniquely an expression of the risk which justifies various considerations extended to investment capital. Therefore to again make ratepayers responsible for such expenses and exonerating investors serves only to make a nullity of the creditability of the investors' claim for a reward for risk.

Cost of Terminating Four Nuclear Generating Units by CAPCO

Two separate recommendations pertained to the resolution of the issues:

(1) ALJ-3 by Judge Matuschak docket I-79070315 and I-79070317

(2) ALJ-9 by Judge Klovekorn docket R-821945

Judge Matuschak issued a report terminating the investigations, and allowing Duquesne Light and Penn Power to amortize their respective portions of the cancellation costs relating to Davis-Besse Nos. 2 and 3 and Erie Nos. 1 and 2, in appropriate rate cases in such amount as therein determined over a period of ten years with no return on the unamortized portion thereof.

Judge Klovekorn noted that Judge Matuschak's report had not been reviewed by the commission in time for inclusion in the final recommendation in the rate case.

The Duquesne Light Company has made a revised claim for $3,469,739 per year for a ten-year period, and has made similar claims in each of its two prior rate cases. Each claim has been rejected pending the outcome of the GAPCO investigation at I-79070315.

The claim is opposed by the trial staff, the consumer advocate, PAJE, and four commercial complainants

(Equitable Life Assurance Society of the United States, Joseph Horne Company, Kaufmann's, and Gimbels), in total and in varying levels of detail.

Despite the fact that *thousands* of pages of text have been dedicated to this issue I will be brief.

1. Philadelphia Suburban Water Co. v Pennsylvania Pub. Utility Commission (1981) 58 Cmwlth 272, 427 A2d 1244: If extraordinary gains on disposal of property not in rate base is not creditable to ratepayers, neither may ratepayers be charged with extraordinary losses on such property. There being no legal basis in Pennsylvania law for the charging of extraordinary losses to ratepayers the claim might be dismissed as a matter of law. However:

2. UGI Corp. v Pennsylvania Pub. Utility Commission (1980) 49 Pa Cmwlth 69, 410 A2d 923: "A public utility is entitled to recover all of its reasonably incurred expenses. The feasibility studies here in question were a direct and clearly prudent step in providing public service and UGI is entitled to recover their cost."

Considering these two Pennsylvania cases together it appears that Duquesne would be entitled to recovery for expense but not property; nor would they be entitled to a return on nonused and useful property.

From this I conclude that:

1. The issue must be remanded to one of the two ALJ's to complete the record.

2. Allowance for funds used during construction included in the claim is merely prior earnings that were capitalized and therefore should not be a part of the claim if no allowance for return on investment is intended.

3. Expenses must be segregated from property so that expenses might be recognized, in particular the site cost, if it is a part of the claim, clearly cannot be passed on to ratepayers under the Philadelphia Suburban Water Company case.

4. The parties to the remand should address the implementation of any recovery either through rates or as credit against a refund or some other appropriate means.

5. No allowance should be made in either the investigation or the rate case.

The very same plants and their related cancellation costs were considered by the public utility commission of Ohio. The Ohio commission, like the majority there, decided to pass the costs through to the ratepayer, making the ratepayer liable for the cancellation of the projects that never would be used or useful. The matter was appealed to the Ohio state supreme court by consumer groups. The Ohio state supreme court overturned the Ohio commission. The utilities then took the Ohio state supreme court decision to the U.S. Supreme Court which refused to review the state supreme court decision. Recently, the U.S. Supreme Court refused to hear the utilities' complaint against the Ohio commission's order reducing rates as a result of these developments.

It seems to me, no matter how different the minor details may be, that having the U.S. Supreme Court refuse to disturb the Ohio state supreme court decision disallowing this kind of a passthrough, requires a little more than a passing glance and explanation.

What the company sought, there and here, and what the commission granted was the amortization as service-

related costs of an investment that never provided any service whatsoever to the utility's customers.

The supreme court of Ohio stated the problem clearly as follows:

"If, as has been argued, these are parlous times for the utilities industry, and if, therefore, in order to attract and retain investment capital, utility companies must not only be granted a fair and reasonable rate of return pursuant to statute but must also be assured the return of capital invested in failed projects that would otherwise not be recoverable under the rate-making formula, then the commission and the utilities should petition the general assembly to enact changes in the rate-making structure so as to provide this extra modicum of protection for the investors. Absent such explicit statutory authorization, however, the commission may not benefit the investors by guaranteeing the full return of their capital at the expense of the ratepayers. Under the rate-making formula now in effect consumers are not chargeable for utility investments and expenditures that are neither included in the rate base nor properly categorized as costs. What we previously stated in a rate base case is applicable to the case at bar: . . . It is only proper that their [the investors] venture be found operational before they commence to recoup their capital outlays from the consumers." Office of Consumers' Counsel v Ohio Pub. Utilities Commission (1979) 58 Ohio St 2d 449, 456, 457, 391 NE2d 311. Ohio, 423 NE2d 820.

I therefore dissent from the recognition in rates of the entire amount claimed toward amortization of the costs of cancellation.

EPRI Dues

The EPRI dues claim is based on anticipated 1983 payments and is clearly outside the future test year and should not have been accepted.

Emergency Energy Surcharge

Inasmuch as the majority relies on Pennsylvania Pub. Utility Commission v West Penn Power Co. (1981) 54 Pa PUC 602, from which I dissented; and because there has been at least one other Duquesne Light rate case begun and closed (R-811470) establishing commission made just and reasonable rates since our decision in West Penn, and because this is a recovery of an extraordinary expense which occurred four years before the test year in this case I object to its allowance here. Furthermore West Penn's claim was adjusted by the commission to reflect only the period after which the surcharge was authorized and certain other offsetting adjustments were adopted which are not apparent here.

RCS Program Expenses

The company is claiming $2,400 for one-year amortization of program start-up costs, $13,000 for one-year amortization of deferred 1981 recurring program costs, and $100,000 for 1982 test-year recurring program costs.

It appears that the $2,400 ($12,031 ÷ 5) nonrecurring start-up costs have been properly recognized and amortized according to Pa Code § 69.73(b).

The company is requesting that the unrecovered 1981 recurring program expense ($64,994) also be amortized over five years. We allowed UGI-Gas to amortize the expenses over two years. Five years is better than two.

The $100,000 test-year recurring program costs are high. Based on my estimates of participation, this amounts to $517 per audit. These high per audit costs are *partially* due to the fact that the company is required to provide program announcements to all of its residential customers while only its electric and oil heating customers are likely to participate in Duquesne's program. Excluding program announcements costs, audits will cost $212 to perform. This may be reasonable considering the very poor economy of scale that the company may be realizing as a result of low participation; i.e., less than four audits per week.

Considering the amount of money involved I support the majority and the company.

The Majority Failed to Amortize Nonrecurring Maintenance Expenses

Trial staff witness Jones testified that the 1982 budgeted amounts for Account 513 and Account 552 should be adjusted downward since the budgeted amounts were a continuation of the 1981 level which included major maintenance work of a nonrecurring nature. The majority rejected the proposed adjustments based upon the view that the analysis of maintenance expenses should be conducted in the context of the company's entire maintenance program. This approach, however, would substantially limit the ability of the commission to examine the reasonableness of Duquesne's future test-year claims.

The test-year data in this rate case is based on the 1982 budget. If this commission were to accept the 1982 budget as the basis for allowable operating expenses simply because the amounts approximate 1981 expense levels, the ability to detect unusual nonrecurring ex-

penses or unreasonable expenses would be completely eliminated. Thus, overstated or unusual 1981 expenses would be built in to the 1982 allowable operating expenses.

With respect to Account 513, the record demonstrates that $2 million of the $2.6 million increase in the 1981 expense level can be accounted for by the major maintenance work that was done at the Cheswick plant. The 1982 budget simply carries forward the 1981 expense level. Based on a five-year amortization of the major maintenance work at Cheswick, 1982 budgeted Account 513 maintenance expenses should be reduced by $1,570,191.

With respect to Account 552, the record demonstrates that $300,000 of the increase in the 1982 budgeted amount was due to the painting project at the company's Brunot Island plant, last performed eight years ago. Based on an eight-year amortization of the painting project costs, 1982 budgeted Account 552 maintenance expenses should be reduced by $262,500.

Normalization of State Taxes

The Pennsylvania Power Company case cited by the majority opinion is in fact the case on which the majority relies. The other cases cited merely refer to the conclusion reached in the Pennsylvania Power case. Much time and effort was expended by the consumer advocate in litigating the issues of law and policy in that case. I found the OCA efforts to produce the correct conclusion and dissented from the majority opinion. That case is on appeal and I am not persuaded that normalization of state income taxes makes sound policy. Nor am I pursuaded that normalization of state income taxes is authorized in Pennsylvania law. I therefore dissent from the resolution of this issue as well.

APPENDIX D

Order of the Pennsylvania Public Utility Commission Upon Reconsideration (Duquesne Light Co.)

Pennsylvania Public Utility Commission

v

Duquesne Light Company

R-821945 et al. I-79070315

April 15, 1983

PETITION for reconsideration of allowance of amortization of canceled plant investment and rejection of conservation plan; granted in part and denied in part. For earlier decision, see (1982) 51 PUR4th 198.

By the COMMISSION:

Opinion and Order
Upon Reconsideration

On February 14, 1982, the Office of Consumer Advocate (OCA) filed a petition for reconsideration and modification of our opinion and order, herein, of January 28, 1983 (51 PUR4th 198). The petition sought reconsideration and modification with regard to two issues; namely:

1. The allowance of the amortization of the investment in certain canceled generating plants; and,

2. The rejection of the OCA's proposed conservation plan.

Additionally, the petition sought clarification of the language and import of the opinion and order, so that nothing contained therein might be construed as approval or endorsement of the continuing CAPCO construction program.

On February 25, 1983, Duquesne Light Company filed its answer. Answers have not been filed by any other party to the proceedings. However, by letter filed February 22, 1983, the commercial complainants stated that they joined with the OCA insofar as its petition seeks reconsideration of the allowance of the amortiza-

tion of Duquesne's investment in the canceled generating plants.

Preliminary Matters

In its answer and opposition to the OCA's petition, Duquesne has asserted that the opinion and order of January 13, 1983, at I-79070315, is not subject to challenge. Duquesne has variously said in this regard, that: "the commission's final order at I-79070315 was entered on January 13, 1983, and as no petition for review was timely filed with respect thereto, that order is *no longer subject to* challenge" (emphasis in original); "the consumer advocate having failed to appeal the January 13, 1983, order is estopped from challenging the propriety of its findings at this date"; and, "as heretofore noted the commission's January 13, 1983, order at I-79070315 is final and may not be attacked by any party to that investigation." While it is true that the time for filing a petition for review with the commonwealth court has run, such assertions are directed to us and we interpret them as urging upon us the position that there is some legal impediment to our consideration of the OCA's petition. However, Duquesne has not explained the exact nature of that claimed impediment. If Duquesne's position is that a petition for reconsideration must be filed with the commission within the time prescribed for a petition for review with commonwealth court, it is incorrect. The applicable commission rule of practice and procedure, appears at 52 Pa Code § 3.291. That rule does not prescribe a time within which a petition for reconsideration must be filed and by its own terms supersedes the provisions of 1 Pa Code § 35.241, which prescribes a 15-day period for such petitions. Consequently, we reject Duquesne's various assertions that the OCA's petition is untimely.

Duquesne also makes reference to our comments in our opinion and order of January 7, 1983, in Duick v Pennsylvania Gas & Water Co. (1982) 51 PUR4th 284, regarding petitions for reconsideration, which was that such a petition, under the provisions of 66 Pa.C.S. § 703(g), "may properly raise any matter designed to convince the commission that it should exercise its discretion under this code section to rescind or amend a prior order." (51 PUR4th at p. 289.) It was further said there that what "we expect to see raised in such petitions are new and novel arguments, not previously heard, or considerations which appear to have been overlooked or not addressed" (51 PUR4th at p. 289), and that parties will not be permitted by a second pleading to raise the same questions which were specifically considered and decided against them. Duquesne urges that the OCA petition be judged by the enunciated criteria. We agree and the enunciated criteria will be applied.

Background

On January 25, 1983, we issued an opinion and order in the above captioned proceeding which, in pertinent part, permitted the amortization of $3,469,739 per year (for a contemplated ten years) of Duquesne's investment in four canceled nuclear generating units, namely Davis Besse Unit Nos. 2 and 3 and Erie Unit Nos. 1 and 2, the stated amount being allowed as an operating expense; and, denied the request of the OCA that Duquesne be required to implement the OCA's proposed multifaceted conservation plan.

The investigation at I-79070315, into the delays in the OCA's continuation program was initiated by commission order of July 27, 1979. In pertinent part, that order stated that:

"In November, 1978, CAPCO[1] announced major delays in the construction schedules of seven large electric generating units ranging from sixteen to thirty-six months.

"The extended schedule of construction will increase the cost of these generating units through inflation and through an increased allowance for funds used during construction (AFUDC). Further, energy costs will probably be higher as these new baseload units will not be on line to serve the consumers' needs.

"We believe that the problems presented by these construction delays merit the commission's consideration; therefore,

"It is ordered:

"1. That a formal investigation is hereby instituted to determine the impact of the CAPCO construction costs upon the rates charged, and the service provided by Duquesne Light Company."

In response to petitions for modification and reconsideration of the July 27, 1979, order, the commission's November 8, 1979, order, clarified the scope of the investigation as follows:

"A thorough evaluation of delays in construction schedules must include an investigation of Duquesne's (Penn Power's) load forecasts, the load forecasts for the CAPCO system as a whole. A thorough evaluation of the best solution to construction delays must include the options of stepping up the schedules of plants under construction, delaying initiation of additional construction, halting construction on some plants, or investing in small other fuel plants. Each option must be con-

[1]CAPCO stands for the Central Area Power Coordinating Group.

sidered and evaluated in terms of its ultimate impact on Duquesne's (or Penn Power's) customers."

By separate order of July 27, 1979, at I-79070316, the commission instituted an investigation into customer conservation incentives, including demand metering. In pertinent part, that order stated:

"Energy conservation is a key concern of this commission and the nation. Not only is it imperative that we get the most out of each Btu and kilowatt-hour, but that we also use each kilowatt of installed capacity most efficiently.

"Over the past several months we have witnessed oil shortages, escalating fuel costs, nuclear outages, and strict environmental regulations on generating stations. We must have conservation. The best way to voluntarily induce effective conservation is through economic incentives.

"It is our belief that Duquesne Light Company should undertake an agressive [sic] imaginative program designed to encourage conservation in order to reduce the costs of providing service; therefore,

"It is ordered:

"1. That within thirty days of entry of this order, Duquesne Light Company shall submit to this commission a conservation plan including, but not limited to the following actions:

"(a) the use of newspaper advertisements and bill stuffers to inform their ratepayers of the need to conserve electricity,

"(b) the negotiation with ratepayers who have standby, emergency or self-generation facilities to make substantial use of such generation, where cost effective,

"(c) the implementation of voluntary load curtailment pursuant to emergency fuel conservation tariff procedures filed in compliance with the commission's order at Emergency Regulation Docket No. 3,

"(d) the implementation of a credit billing system which rewards conservation through a credit per kilowatt-hour and reduces the bills of ratepayers who achieve at least 5 per cent conservation, determined from past consumption in like periods, and thereby lessens the need for purchases of high cost energy,

"(e) the proposed implementation of curtailment and conservation procedures for commercial and industrial ratepayers shall be accompanied by specific proposals to encourage such conservation through the elimination of 'ratchet' or historic demand charges and minimum bills for those ratepayers who do conserve and through the incremental pricing of usage in excess of the targeted conservation consumption for those ratepayers who do not conserve.

"2. That within sixty days of the date of this order, Duquesne Light Company shall submit a plan to this commission for the implementation of a demand-metered rate for residential customers and a plan for converting residential customers to demand meters. A detailed benefit-cost analysis of this proposal must accompany the plan."

On August 10, 1979, Duquesne filed a petition for termination of the investigation and a petition for extension of filing deadline. By order entered October 22, 1979, the commission denied the petition for termination of investigation, but granted the petition for extension of filing deadline. On November 19, 1979, the revised energy conservation plan was filed with the commission.

On January 29, 1980, the trial staff, noting the filing of the conservation plan, requested that the docket be closed. The company joined in the request. On February 21, 1980, the OCA filed a motion to consolidate the CAPCO investigation with the conservation investigation. Both requests were effectively denied by the commission's order of June 11, 1980, initiating an investigation into the company's general rate increase application at R-80011069, which consolidated the proceedings at I-79070316 with the proceedings at R-80011069.

On February 20, 1981, we entered an opinion and order in the consolidated proceedings, wherein it was concluded that the areas of investigation specified in the order of July 12, 1979, at I-79070316 had not been adequately addressed. Consequently, the investigation was not addressed in that opinion and order, and it was provided that the investigation remain open until further order.

On April 30, 1981, Duquesne filed a general rate increase application which was docketed at R-811470. That proceeding, after acceptance by Duquesne of an option order by filing revised tariffs on June 30, 1981, which tariffs were accepted on July 17, 1981, proceeded to hearing. The proceedings were terminated by our opinion and order of April 19, 1982, which found the rates contained in the option order tariff filing of June 30, 1981, accepted July 17, 1981, were just and reasonable.

On April 30, 1982, Duquesne filed the instant application for a general rate increase, docketed at R-821945. This proceeding was terminated by our opinion and order of January 28, 1983 (51 PUR4th 198), which granted approximately $106 million of the requested increase of approximately $165 million. Included in the

operating expenses found reasonable were $3,469,739 which represented one year's recovery of a ten-year amortization of the Duquesne investment in the four canceled CAPCO nuclear generating units, the unamortized balance of which was excluded from rate base. Additionally, that opinion and order declined to adopt the OCA's proposed five-point conservation plan for Duquesne, deferring any decision regarding any expanded conservation plan for Duquesne, until the conclusion of the generic investigation into a proposed policy position regarding regulatory treatment of conservation and load management programs, at I-801-00341 (49 PUR4th 165).

Requested Clarification

In its petition the OCA claims that the ALJ's recommended decision contains a number of erroneous conclusions. The OCA then requests that, in light of ALJ's conclusions with which it takes specific issue and other unidentified errors, our opinion and order of January 28, 1983, "be modified so that it shall not be construed as an endorsement of the continuing CAPCO construction program."

In its answer, Duquesne, has first asserted that the OCA, having failed to appeal the order of January 13, 1983, at I-79170315, is estopped from challenging the propriety of the findings at this time. We disagree with this conclusion because unlike the rules of appellate procedure, there is no time limit placed upon a petition for reconsideration under our rules of practice and procedure. Duquesne then quotes the ALJ's conclusion at p. 74 of his report of investigation:

"That the CAPCO program for the completion of the construction of Perry No. 1 and No. 2 and Beaver

Valley No. 2 is the reasonable and prudent course of action, and that Dr. Rosen's recommendations must be rejected."

Duquesne states that the ALJ's conclusion is fully supported by the evidence, and that "the commission has adopted this finding as its own."

In light of the conclusion stated by Duquesne it appears necessary that we clarify the import of our order of January 13, 1983, and our opinion and order of January 28, 1983. Perhaps the order of January 13, 1983, more appropriately, should have stated that we accepted or approved the ALJ's report of investigation, for it was our intention to only specifically endorse those conclusions contained therein which were necessary antecedents to the action taken, which was to allow the amortization of the costs incurred, with regard to the canceled generating plants, over a ten-year period. This action only required a decision on our part as to two essential matters. First, that the initial decisions by Duquesne and the Pennsylvania Power Company to participate in the ownership of these four generating plants was prudent at the time at which it was made. Second, that the decisions to delay cancellation until 1980, when that decision was made, were prudent. Stated in another manner, we conclude that the interim decisions regarding the four generating plants were prudent.

Since any conclusions expressed by the ALJ on any other subject or matter addressed in his report of investigation are not necessary antecedents to our action, our action does not constitute an endorsement or adoption of those conclusions.

With regard to our opinion and order of January 28, 1983, we stated that we had adopted ALJ Matuschak's

report of investigation. While we might more appropriately have said that we "approved" that report, we went on to characterize the effect of that action as a passing upon "the merits of Duquesne's request to amortize their cancellation costs . . . over a period of ten years, with no return on the unamortized balance thereof." (51 PUR4th at p. 218.)

With this clarification provided we do not believe that there should be any misconception that our order of January 13, 1983, or our opinion and order of January 28, 1983, constitute an endorsement of the continuation of the construction on Perry No. 1 and No. 2 and Beaver Valley No. 2 either prospectively or for any past period. Our actions constitute no comment upon either past or current decisions with regard to these three generating units.

CAPCO Cancellation Costs

In its petition the OCA calls our attention to Senate Bill 1366 which became Act 335 on December 30, 1982, with an immediate effective date. This act adds § 1315 to 66 Pa CS, and the bill as enacted is as follows:

"*Section 1.* Title 66, Act of November 25, 1970 (PL 707, No. 230), known as the Pennsylvania Consolidated Statutes, is amended by adding a section to read:

"Section 1315. Limitation on consideration of Certain Costs for Electric Utilities.

"Except for such nonrevenue-producing, nonexpense-reducing investments as may be reasonably shown to be necessary to improve environmental conditions at existing facilities or improve safety at existing facilities or as may be required to convert facilities to the utilization of coal, the cost of construction or expansion of a facility

undertaken by a public utility producing, generating, transmitting, distributing, or furnishing electricity shall not be made a part of the rate base nor otherwise included in the rates charged by the electric utility until such time as the facility is used and useful in service to the public. Except as stated in this section, no electric utility property shall be deemed used and useful until it is presently providing actual utility service to the customers.

"*Section 2.* This act shall be applicable to all proceedings pending before the public utility commission and the courts at this time. Nothing contained in this act shall be construed to modify or change existing law with regard to rate-making treatment of investment in facilities of fixed utilities other than electric utilities.

"*Section 3.* This act shall take effect immediately. Act amending Title 66 (Public Utilities) of the Pa.C.S., No. 335, December 30, 1982 (to be codified at 66 Pa.C.S. § 1315)."

The OCA states its conclusion that Duquesne's recovery of its investment in the canceled generating plants is precluded by the quoted recent legislature enactment "in that it allows the inclusion in rates of the cost of construction of an electric utility facility which is not presently providing and, in fact, will never provide actual utility service to its customers." The OCA does not continue and provide any argument or reasoning in support of its stated conclusion.

Duquesne has responded to the OCA's stated conclusion and urges that the OCA's conclusion is contrary to the intent of the legislature in adopting the act.

In reviewing the act we find that in general terms it provides that, except for nonrevenue-producings, non-

expense-reducing investments in facilities to improve environmental conditions or safety at existing facilities or as may be required to convert facilities to coal, the costs of construction or expansion of a facility shall not be included in rate base *nor otherwise included in the rates charged* until the facility is used and useful, which is defined as presently providing actual utility service. The proscription of the act is in accord with historic commission regulatory practice regarding electric utilities. The OCA's claimed impediment appears to rely upon the words "nor otherwise included in the rates charged by the electric utility" to support its position, implicitly claiming that the amortization of costs incurred prior to cancellation of the plants (as an alternative to depreciation since there is no depreciable property) is a prohibited inclusion of the costs of construction in rates. In our view the quoted portion of the act is not entirely clear and to our knowledge there is no regulatory practice or utility-proposed regulatory treatment as an alternative to inclusion in rate base, which this disjunctive phrase is designed to prevent. Consequently, to our reading the quote disjunctive prohibition is merely designed to prohibit both the inclusion of construction work in progress in rate base and any alternative rate-making action, which some inventive mind might create, as an alternative which would accomplish the same or similar result. In attempting to ascertain the intent of legislation 1 Pa.C.S. § 1921(c) lists some eight matters which may be considered. Among these is the "object to be obtained." In this regard the language of the act is in complete accord with the historic commission practice with regard to regulatory treatment accorded to construction work in progress rate base claims, and in this respect we view the act as both a legislative endorsement of historic commission practice

and a mandate to continue that practice, rather than an enactment to achieve some different objective. In similar view, with regard to the consideration of the "mischief to be remedied" we perceive that there was no existing mischief or regulatory practice which the act was designed to remedy, but rather that the enactment was designed to prohibit any possible change to an unacceptable practice.

The last of the enumerated considerations which we believe are pertinent here is that of the "consequences of a particular practice." Were we to accord to the phrase in question, the very literal interpretation which the OCA seemingly urges, any construction expenditure for a facility not used and useful, that is presently providing "actual utility service," could neither be included in rate base or recognized in any manner in rates. This very literal interpretation would exclude rate base recognition or the fair rental expense recognition of a utility office building because it would never be utilized in providing "actual utility service." Similarly, any other structure not utilized in the generation, transmission, and distribution of service could neither be included in rate base or recognized on a fair rental expense basis.[2]

A similar very literal interpretation would also preclude the recovery of unrecovered investment in prematurely retired utility plant (since such plant would no longer be used and useful), the recovery of which is clearly contemplated and provided for in the Uniform System of Accounts for electric utilities and which is the regulatory treatment which this commission has accorded to such unrecovered investment in appropriate

[2]Pa.C.S. § 1921(1) also provides "[t]hat the general assembly does not intend a result that is absurd, impossible of execution or unreasonable."

instances in the past. We do not perceive any legislative intent to prohibit this regulatory practice.

In its answer, Duquesne has pointed out an additional consequence of the OCA's very strict interpretation of the act, which is that a utility would be prompted to continue with construction to completion in order that rate base inclusion be accorded to such plant even though the most reasonable economic decision would be to terminate construction. Duquesne also raises an issue as to the constitutionality of the act, if, based upon a strict interpretation of the act, it is precluded from recovery of a prudently incurred capital expenditure. While we will not undertake to resolve this issue, we do believe that this issue of constitutionality is real and not fanciful.

Having considered the matters discussed above we are led to the conclusion that the legislature did not intend that the act be interpreted in the manner urged by the OCA but rather it was an endorsement of past commission regulatory treatment of construction work in progress and a prescription of the continuation of that practice. Viewed in this light, the troublesome phrase of "nor otherwise included in the rates charged by the electric utility" merely precludes some alternative regulatory treatment to inclusion in rate base, designed to circumvent the letter of the act and achieve the same or similar result to that achieved by rate base inclusion and not a prohibition of the recovery of prudent investment in a plant which is prematurely retired or one which is canceled by reason of a change in economic circumstances. We conclude, therefore, that the OCA's objection is not well taken and our approval of amortization of the investment in the four canceled generating plants does not contravene the act and accordingly, its request that such costs be disallowed is denied.

Conservation Program

Initially the OCA notes: (1) that in our opinion and order of January 28, 1983, we decline to adopt and mandate its proposed five-element conservation program for Duquesne, stating that in light of the existence of the current generic investigation we deemed it wise to await the outcome of that investigation prior to mandating any additional conservation action for Duquesne; (2) that our order adopted September 17, 1982, initiating that investigation stated that "this investigation should not impede the progress of any conservation or load management effort being undertaken by any utility"; and, (3) that Duquesne has presented testimony in the CAPCO proceeding that it believes that it will be deficient in capacity in the late 1980s or early 1990s and be marginal in the mid-1980s.

The OCA then asserts that for both the purposes of reliability and economy, "Duquesne's ratepayers are entitled to immediate implementation of any and all cost-effective conservation measures" and that "[r]egardless of the arguments as to the merits of individual line items in the OCA's five-point program, there can be no reasonable doubt that, based on the record in this proceeding, a substantially more extensive program than the informational program now in place is cost effective for this utility which has the second highest rates in the state."

The OCA concludes with the assertion that failure to order a cost-effective program is a violation of our statutory mandate pursuant to §§ 1301, 1501, and 308 of the Public Utility Code.

We disagree with the conclusion of the OCA that our action in rejecting its proposal to mandate its five-point

conservation program is violative of our duties under the Public Utility Code. Further, the OCA's comments and assertions have not convinced us that our rejection of its proposed conservation program was unwise. Our desire to await the outcome of the generic investigation before mandating addition[al] actions by Duquesne does not, as we said, impede any actions which it might wish to undertake, and we believe that the end result which will be forthcoming from the generic investigation, has a much greater likelihood of being an effective, comprehensive approach to both conservation and the abatement of load growth, than does any program which would be adopted at this point in time.

Conclusion

Having fully reconsidered the assertions and arguments of the OCA we are not satisfied that our decisions on the two issues of: (1) the amortization of Duquesne's investment in the canceled generating plants; and, (2) the rejection of the OCA's proposed five-element conservation plan was either unwise or in error, and, consequently, no modification of our opinion and order of January 28, 1983, is either appropriate or required. As to the matter of the import of our opinion and order of January 28, 1983, and our order of January 13, 1983, as it pertains to the continuation of construction on the remaining three generating plants, we have provided what we believe to be the necessary clarification.

APPENDIX E

Order of the Pennsylvania Public Utility Commission (Pennsylvania Power Co.)

Pennsylvania Public Utility Commission et al.

v

Pennsylvania Power Company

Additional complainants: Office of Consumer Advocate, Sharon Steel Corporation, and Borough of Enon Valley et al.

R-832409 et al.
April 6, 1984

APPLICATION *for authority to increase electric rates; granted as modified; income tax expenses reduced by hypothetical interest deduction associated with unamortized job development investment tax credit.*

Opinion and Order

By the COMMISSION:

I. *Introduction and History of the Case*

On July 13, 1983, Pennsylvania Power Company (Penn Power or the company) filed with the Pennsylvania Public Utility Commission (PUC or the commission) Supplement No. 29 to its Tariff Electric-Pa PUC No. 33 to become effective September 11, 1983. Supplement No. 29 requests an increase in the company's total annual operating revenues of $19,890,200 based upon a future test year ending March 31, 1984.

By order entered August 20, 1983, we instituted a formal investigation (docketed at No. R-832409) to determine the lawfulness, justness, and reasonableness of the proposed rates and of existing rates. Supplement No. 29 was thereby suspended by operation of law for the seven-month period provided under § 1308 of the Public Utility Code (66 Pa.C.S. § 1308), or until April 11, 1984,

and assigned to Administrative Law Judge Allison K. Turner for hearing and the issuance of a recommended decision.

Commission prosecutory staff (staff or trial staff) filed its appearance and has participated fully. A total of four complaints were filed against the proposed rates by the office of Consumer Advocate (OCA or the consumer advocate); Sharon Steel Corporation (Sharon); the borough of Enon Valley; and State Representative Ralph D. Pratt. These complaints were consolidated with the commission's investigation for the purposes of hearing, argument, and disposition. In addition, the city of New Castle submitted a letter protesting the increase during the course of hearings, the letter having been signed by the city council president and four council members.

A prehearing conference was held in Harrisburg on September 20, 1983, before the administrative law judge (ALJ) and, pursuant to commission policy, public input sessions were later held in Sharon and New Castle. In addition, a total of thirteen days of hearings were held in Pittsburgh and Harrisburg between October 12, 1983, and December 14, 1983, producing over 1,400 pages of transcript.

During the course of the hearings, the company submitted 16 written statements prepared by ten witnesses and filed 16 exhibits. The staff presented 12 written statements through eight witnesses and formally designated 20 exhibits; OCA presented four witnesses and submitted numerous exhibits; Sharon submitted two written statements and exhibits through one witness. Sharon's participation has been limited to the basic issue of rate structure, including rate design, cost of service, and attendant revenue adjustments. The other named parties did not participate actively in the hearing or briefing process.

The evidentiary record was closed December 30, 1983. Briefs and reply briefs have been filed by the company and the three active parties. Sharon filed a motion to strike a portion of staff's reply brief which was granted by ALJ Turner.

ALJ Turner's recommended decision was issued for exceptions on February 28, 1984. The ALJ recommended that Penn Power be allowed to file tariffs or tariff supplements to provide annual electric operating revenues of $179,703,000, exclusive of state tax adjustment surcharge revenues and net energy clause revenues. ALJ Turner indicates that this would produce an increase in annual base rate operating revenues of approximately $10,015,000.

Exceptions to the ALJ's recommended decision were filed by Penn Power, staff, OCA, and Sharon. Reply exceptions were filed by the same parties.

On March 15, 1984, staff filed a motion to strike an affidavit submitted by Penn Power which attempted to proffer new evidence in the nature of the percentage increases in management salaries actually granted by the company. We find merit in the arguments presented by staff in support of its motion to strike. Accordingly, the motion to strike is hereby granted.

For the reasons fully discussed within the body of this order, we shall permit Penn Power to file tariffs designed to produce annual electric operating revenues of $184,186,000, exclusive of state tax adjustment surcharge revenues and net energy clause revenues. This

will result in an annual increase in base rate operating revenues of approximately $15,364,000.

II. *Description of the Company*

ALJ Turner provided a description of Penn Power which we shall reproduce below:

"Penn Power is a regulated Pennsylvania public utility and is a wholly owned subsidiary of Ohio Edison Company (Ohio Edison).[1] The history of the company, which includes the purchase, consolidation, and merger of 139 formerly independent operating companies, is set forth in PPC Exh I, Schedule I-A-1. Penn Power's principal executive offices are located at New Castle, Pennsylvania.

"At March 31, 1984, the company will render electric service to approximately 126,633 retail customers. Its service territory, which has a total population of 350,000, encompasses an area of 1,517 square miles in western Pennsylvania, including all of Lawrence and Mercer counties and portions of Allegheny, Beaver, Butler, and Crawford counties. The company additionally provides wholesale electric service to five municipal customers under rates prescribed by the Federal Energy Regulatory Commission (FERC).

"The company's largest source of base-load generation is its own New Castle plant which consists of five separate coal-fired units. In addition, as a member of the Central Area Power Coordinating Group (CAPCO),[2] the company shares in the ownership of

[1]Ohio Edison, a registered holding company under the Public Utility Holding Company Act of 1935, provides electric service throughout a 7,500 square mile area in central and northeastern Ohio.

[2]Other members of CAPCO include Ohio Edison, Duquesne Light Company, Cleveland Electric Illuminating Company, and Toledo Edison Company. In the aggregate, the CAPCO companies service an area of 14,000 square miles in western Pennsylvania and northern and central Ohio with a population of approximately 7 million.

Bruce Mansfield Units Nos. 1, 2, and 3 and Sammis Unit No. 7, all coal burning facilities, and of Beaver Valley Nuclear Unit No. 1. Finally, together with Ohio Edison, Penn Power owns a share of four smaller peaking units (diesel or combustion turbine).

"The principal facilities of the company, including transmission lines and substations, as well as the extent of the company's service territory, are shown on the system map included in PPC Exh I, Schedule I-B-7. Penn Power presently employs approximately 1,860 men and women to meet the needs of its customers."

III. *Rate Base*

A. *Fair Value*

Penn Power has presented only an original cost measure of value in this proceeding. We therefore will adopt the original cost measure of value as the fair value rate base.

B. *Net Original Cost of Plant in Service*

The company has claimed a rate base, or measure of value of its property, of $414,902,134 based upon the future test year ending March 31, 1984, consisting of $548,281,771 of gas plant in service (original cost), less a calculated depreciation reserve of $135,949,107, plus $842,074 for plant held for future use, $3,942,885 for leased nuclear fuel, less deductions of $21,823,515 for advances for construction, deferred income taxes, and deferred investment tax credits, plus a working capital claim of $19,608,026, as set forth in the following tabulation:

	Total Company Original Cost (1)	*Adjusted* (2)	*Adjusted Total* (3)	*Less Resale* (4)	*Pennsylvania Retail* (5)
Plant					
Plant in Service	$567,132,395	$(783,332)	$566,349,063	$18,067,292	$548,281,771
Computed Reserve	140,175,805	(130,532)	140,045,273	4,096,166	135,949,107
Net Plant in Service ...	$426,956,590	$(652,800)	$426,303,790	$13,971,126	$412,332,664
Plant Held for Future Use	875,146	—	875,146	33,072	842,074
Leased Nuclear Fuel ...	4,110,587	—	4,110,587	167,702	3,942,885
Pollution Control Facilities Under Construction at Existing Plants	—	—	—	—	—
Net Plant	$431,942,323	$(652,800)	$431,289,523	$14,171,900	$417,117,623
Deductions					
Customer Advances for Construction.....	315,000	—	315,000	—	315,000
Deferred Income Taxes.	21,817,434	—	21,817,434	771,260	21,046,174
Deferred Investment Tax Credits.....	475,307	—	475,307	12,966	462,341
Total Deductions	$ 22,607,741	—	$ 22,607,741	$ 784,226	$ 21,823,515
Additions					
Working Capital Requirement -- Cash	4,690,562	—	4,690,562	121,044	4,569,518
Other	15,596,800	—	15,596,800	558,292	15,038,508
Total Working Capital.....	$ 20,287,362	—	$ 20,287,362	$ 679,336	$ 19,608,026
Measure of Value	$429,621,944	$(652,800)	$428,969,144	$14,067,010	$414,902,134

Penn Power states that the undepreciated original cost of electric plant in service, at the end of the historic test year (March 31, 1983) was taken directly from the company's continuing property records; that the booked original cost values were originally approved by the commission in the mid-1940s and have since been maintained in conformity with the Uniform System of Accounts for Class A electric companies as prescribed by the Federal Energy Regulatory Commission; and, that the account balances are audited periodically by our staff and, on an annual basis, by a firm of independent certified public accountants.

In deriving the original cost measure of value at future test-year-end, the company adjusted the actual plant balances at March 31, 1983, as set forth in its books of account, to reflect those plant additions and retirements anticipated to occur during the twelve

months ending March 31, 1984. From the resulting figure ($567,132,395), an amount of $783,332, representing the public utility realty tax (PURTA) and associated allowance for funds used during construction (AFUDC) erroneously capitalized in prior years, was deducted.

C. *Generating Capacity*

OCA urges that the value of 72 megawatts of the company's generating capacity be found excessive with a resulting reduction of $28.3 million[3] in the claimed rate base. This adjustment is based upon the OCA's allegation that the company presently has a net total capacity of 752 megawatts compared to a 1983 peak load of 567 megawatts, and that a generating reserve margin of 20 per cent is reasonable. OCA cites numerous decisions of other jurisdictions and this commission, relative to the propriety of a commission making an excess generating reserve adjustment. We need not look to precedent from other jurisdictions in view of the following pronouncement of our commonwealth court on this issue as set forth in Philadelphia Electric Co. v Pennsylvania Pub. Utility Commission (1981) 61 Pa Cmwlth 325, 433 A2d 620:

"PECO contends that because its decisions to construct the eliminated units as well as its decisions to construct every other of its generating units, when made, were prudent, the PUC may not now remove any of these properties from rate base because there is presently excess capacity. This argument, however, misses the point of the determination. The PUC's order specif-

[3]OCA would permit the company to include in the company's cost of service depreciation and operating expenses associated with the claimed excess capacity, thus depriving Penn Power of a return *on* the investment but not a return *of* the investment.

ically states that the PUC was 'not questioning PECO's management decisions made when these units were constructed.' The basis for the order is the finding that to the degree that there is excess capacity, there are generating properties which are not used and useful in rendering service to ratepayers.

"A unit may be properly excluded from a utility's rate base if the investment in that unit is found to be a result of managerial imprudence occurring at the time the decision to invest was made. See, e.g., UGI Corp. v Pennsylvania Pub. Utility Commission (1980) 49 Pa Cmwlth 69, 82-87, 410 A2d 923, 932. It does not follow that a unit prudently constructed must always be included in the rate base. *The touchstone for determining whether or not a prudently constructed unit should be included in a utility's rate base is whether or not, during the test year involved, the unit will be used and useful in rendering service to the public.* Id., 433 A2d at pp. 622, 623 (emphasis added)."

OCA witness Leonard S. Gold testified that Penn Power currently has a total generating capacity of 872 megawatts in the winter and 862 megawatts in the summer, during the future test year. After adjustments recognized future test-year sales of 49 megawatts to Ohio Edison, sales of 21 megawatts to Potomac Electric Power Company, and sales of 28 megawatts to General Public Utilities, the company's capacity for the future test year is 752 megawatts in the summer of 1983 and 762 megawatts in the winter of 1983-84. Mr Gold utilized a peak load of 567 megawatts for the future test year, which would produce a reserve margin of 185 megawatts (752 megawatts – 567 megawatts = 185 megawatts), or a reserve margin of 32.6 per cent.

Mr. Gold recommends a generating reserve margin of 20 per cent for Penn Power in this proceeding, based upon the witness' experiences in the utility industry and prior decision of this commission. Although this witness stated that generation mix, availability of generating units, rates of forced outage, transmission capabilities, interconnections with other utilities, and transfers of energy during emergency situations are factors to be considered in determining a generating reserve margin, he generally recommended a reserve margin of 15 per cent to 20 per cent as being used quite extensively in the electric industry.

The OCA further contends that Penn Power's excess generating capacity will not be reduced in the near future.

We note that Penn Power has claimed no costs, in this proceeding, associated with Perry electric generating Units Nos. 1 and 2, presently under construction; therefore, we are presented with no issues arising from the construction of these generating units or of the propriety of including these generating facilities in rate base.

Although Penn Power has presented substantial argument that all of the company's presently existing generating capacity passes the prudency test when the decisions to construct these plants were made, we are here primarily concerned with the issue of whether the existing generating capacity is used and useful in rendering service to the public. This is the "touchstone" referred to in Philadelphia Electric.

Penn Power contends that all of its generating facilities are, in fact, used in providing electric service, and that all of the company's generating plants, with the ex-

ception of facilities used solely for peaking purposes, are projected to operate at capacity factors of 56 per cent or higher during the future test period.

The company further contends that, in all likelihood, its reserve margin will drop significantly below 30 per cent during the period in which the rates determined in this proceeding will be in effect. In this regard, the company's witness Pazak testified that the company has been advised that one of its major industrial customers, Babcock and Wilcox, anticipates adding 40 megawatts of load in the second half of 1984, which additional load would reduce its reserve margin to approximately 26 per cent; and that if its peak load of 577 megawatts for 1981 were repeated, its reserve margin would fall to 23.8 per cent.

The company also presented evidence concerning increased peak requirements which could materialize as a result of an economic recovery in its service territory. Dr. Gerber testified:

"Penn Power Company had already reached a summer peak of 577 megawatts in 1981 prior to the slide into the deep recession that was experienced during the latter half of 1981 and 1982. Thus, the projection of 572 megawatts for the summer of 1984, shown on OCA Exhibit LSG-2, is less than the peak already reached in 1981 by Penn Power Company. Even if the anticipated 40 megawatts of additional Babcock and Wilcox load expected to come on line in 1984 were ignored, the economic recovery we are presently experiencing could result in a peak demand on the Penn Power system considerably above the projection of 572 megawatts for the summer of 1984 and well above the winter, 1984-85 projection of 589 megawatts. For example, the twenty

largest customers served by Penn Power Company reached a peak in 1981 that was almost 40 per cent above the peak demands they reached since then. In short, as economic recovery proceeds, one can expect that the demand level will return to the highest levels reached previously and could go well beyond that level."

In further support of its contention that all existing generating capacity is used and useful in the rendition of electric service, Dr. Gerber presented the following testimony indicating that the existing production facilities have generated significant economic benefits in terms of lower capital and operating costs:

"Penn Power Company and its customers have been the beneficiaries of the company's efforts to increase coordination and integration with other systems through its participation in CAPCO as well as its being part of the Ohio Edison system. This has permitted the company to take advantage of various substantial economics of scale which would not have been available were it operating independently. For example, Penn Power Company has participated in the ownership of Bruce Mansfield Units 1, 2, and 3. These are 835-megawatt units of which Penn Power has ownership of a total of 144 megawatts. Its ownership is distributed among the three units and, therefore, Penn Power Company has distributed its risk in the operating efficiency and unit availability of its 144 megawatts among those three units rather than risking it all in a single unit. Penn Power Company has obtained the economies of scale available from the construction of an 835-megawatt unit at a time when it could not, standing alone, given its size, have been capable (at least with any degree of prudence) of building a unit any larger

than 100 or 150 megawatts. Even that size would have been stretching things quite a bit. The difference in the construction costs between the 835-megawatt units and 100- or 150-megawatt units could well have been somewhere in the neighborhood of $75 to $100 per kilowatt of capacity. It is a rather simple matter of multiplication to determine what that has saved Penn Power Company and its customers in carrying charges on fixed investment. One hundred and forty-four thousand kilowatts which achieve a saving of $100 per kilowatt results in an investment saving of $14.4 million. A saving of that magnitude in investment saves carrying charges for Penn Power Company and its customers of something in the neighborhood of $2.5 million a year."

Dr. Gerber also testified that the level of needed capacity must be evaluated in light of the load and generating mix characteristics of the particular electric system under consideration. For example, this witness stated that a significant share of Penn Power's industrial load operates at high load factors with leapfrogging peaks which necessitates the planning of maintenance work during peak periods. He testified:

"Penn Power Company's load is characterized by a significant share of industrial load that operates at high capacity—i.e., load—factors. The result is that the system as a whole has a very high capacity (load) factor with leapfrogging peaks. This is, the peak in the summer can exceed the peak in the previous winter and then the peak in the following winter will exceed the peak in the previous summer. This system also has a capacity (load) factor that is close to 70 per cent. This means that it is necessary to plan to do maintenance during the peak periods. It also increases the probability that there will be forced outages of generating

capacity during the peak periods. Indeed, if one examines the Penn Power Company maintenance schedules and their unexpected forced outage experience, one finds that some planned maintenance is scheduled for the peak periods and both forced outages and maintenance outages occur throughout the year and frequently during peak periods. Under these circumstances, the system requires a higher level of reserves to permit it to accommodate such outages.

The OCA has presented testimony and extensive argument in support of its recommended 20 per cent reserve generating capacity which it characterizes as being an acceptable standard or bench mark in the electric generating industry. This commission, as early as 1972, urged a reserve capacity of *at least 20 per cent* in Pennsylvania Pub. Utility Commission v Duquesne Light Co. (1972) 46 PUC 427, 437, 438 in order "[T]o cover peak loads, scheduled maintenance, and forced outages in order to avoid blackouts, load curtailments, and voltage reductions." We do not believe, however, that a capacity reserve margin of 20 per cent or any other specific percentage could or should apply as an industry standard. An acceptable reserve generating capacity margin for any particular electric utility is dependent upon the generation mix, availability of generating units, peak-load requirements, the period during which the peaking capacity is required, rates of forced outages, transmission capabilities, interconnections with other utilities, and transfers of energy during emergency. These are some of the operating factors which must be considered when reaching a determination concerning an acceptable generating reserve margin.

As stated previously, Penn Power is not in this proceeding making a rate base claim for newly con-

structed or recently completed generating capacity which would, of necessity under current conditions, result in an increase in its recently experienced reserve generating capacity margin.

In reaching a determination of whether a generating capacity adjustment should be made in this proceeding, we have given consideration to the established fact that a significant share of the company's industrial load operates at a high load factor which would require outages of generating capacity during peaking periods in order to perform required maintenance.

We take notice that the company's present reserve generation margin of approximately 32 per cent is attributable, in part, to the depressed economic conditions in Penn Power's service territory, a condition over which the company has no control. This is not to state that a generating capacity reserve margin adjustment would be improper in all circumstances when attributable to depressed economic conditions. However, in the case of Penn Power, the economic conditions existing in the service area have contributed to the existing reserve margin which we do not find to be excessive in accordance with the foregoing discussion. Accordingly, the OCA's adjustment will not be made.

D. *Depreciation Reserve*

Penn Power claims a calculated, or "computed" depreciation reserve of $135,949,107 at March 31, 1984, which was prepared in accordance with a methodology similar to that used in its calculated depreciation reserve presented in prior rate proceedings before this commission.

In order to calculate accrued depreciation at March 31, 1984, the company's witness Earl M. Robinson, vice

president and general manager of Weber, Frick & Wilson, Inc., determined the attained ages and estimated service life characteristics for each group of depreciable utility plant. Mr. Robinson relied extensively on a comprehensive depreciation study prepared by Weber, Frick & Wilson, Inc., for the company in conjunction with its 1979 rate filing (Docket No. R-7912020). After analyzing and testing the results of that study, this witness concluded that, with the exception of the production plant accounts, the service lives and life characteristics developed therein remained appropriate for use in the current proceeding.

Major generating plant was depreciated by utilizing the life span procedure. This methodology consists of the development of a life span or probable retirement date for each generating unit which, when combined with a curve reflecting anticipated interim component retirements, yields the appropriate amount of accrued depreciation attributable to the plants in question. The interim retirement rates employed by Mr. Robinson for purposes of life spanning the company's investment in steam and nuclear production plant facilities were the same as those which were presented to and approved by the commission in Pen.. Power's most recent fully litigated rate proceeding. See: Pennsylvania Pub. Utility Commission v Pennsylvania Power Co. (1982) 55 Pa PUC 552.

In Penn Power's prior rate proceeding, Docket No. R-811510, Jan. 22, 1982, we directed (55 Pa PUC at p. 590):

"10. That Pennsylvania Power Company perform a study to allocate its book reserve over each plant account by vintage for all production plant. Prior to com-

mencement of this study, the company shall secure the approval of [the] electric division in the bureau of rates as to the allocation methodology to be used in the study."

Pursuant to the above directive, the company met with our staff to determine the appropriate allocation methodology to be used in the depreciation reserve study. Based on those discussions, the scope of the study was expanded to encompass all plant in service. On February 18, 1983, the completed study was submitted by Penn Power to the commission. The company contends that although it invested a significant amount of time and effort in preparing the study which we directed be prepared, and although it is of the view that this study can play a valuable role in the ultimate resolution of the appropriate depreciation reserve for Penn Power, it nevertheless contends that its calculated reserve, and annual depreciation expense as claimed by the company should be approved in this proceeding.

Alternatively, Penn Power urges that if we should conclude that the conversion from a calculated depreciation reserve to a book reserve should be initiated at this time, the February 18, 1983, report represents the most reasonable and equitable approach to the depreciation reserve issue. Following is a summary of the company's proposal as described by Mr. Robinson:

"The company proposed to change, for both rate making and book purposes, the basis of its depreciation expense and depreciation reserve. In making this change, the company proposed to adopt the average remaining life methodology in lieu of the presently utilized whole life average service life method. Further, the company proposed for rate making to change from

using a calculated depreciation reserve to a book depreciation reserve. The starting point depreciation reserve for going forward with average remaining life was to incorporate the calculated depreciation reserve as of the point in time in which the methods were changed. Going forward from the changeover date, the company agreed to utilize the same depreciation rates per books as allowed in its rate cases together with an annual recalculation of depreciation rates, utilizing approved service life parameters, as a constant trueup procedure for its book reserve. Further, the company agreed to complete timely depreciation service life studies to update the service lives of the property. Also included in the proposal was a request to incorporate prospective net salvage into the annual depreciation rates. Given the commission's current policy and position with regard to prospective net salvage, the company would accept the continued use of the five-year average experienced net salvage in lieu of its proposal. In summary, the company's rate base and depreciation expense would be based upon the adoption of the average remaining life depreciation method going forward from a starting point depreciation reserve equal to the calculated reserve as of the changeover date. The difference between the company's calculated reserve and book reserve at that point in time would be amortized over an appropriate period below the line."

Trial staff has recommended that, in this proceeding, a move be initiated toward the use of the book depreciation reserve to calculate the appropriate depreciation reserve and to the use of remaining life for the purpose of calculating the annual depreciation expense.

Trial staff witness Michael J. Gruber developed his adjusted book depreciation reserve by taking as the

starting point, the calculated reserve *at December 31, 1971, adjusted to reflect the depreciation expense that would have accrued since that time using the service lives submitted by Penn Power or approved by the commission in each rate case during that period.* In developing this adjusted book reserve, he relied exclusively on data supplied by the company.

Mr. Gruber then calculated the appropriate depreciation expense using remaining life depreciation. Under this methodology, the remaining life for a unit of property is calculated and the net depreciated value of plant is calculated. This net value is collected equally over each year of the unit's remaining life. Stated differently, the reserve is deducted from the original cost rate base, and the net plant is then divided by the average remaining life to arrive at the annual expense by account. These account expenses then are totaled to derive the annual depreciation expense.

In substance, Mr. Gruber actually reconstructed what the company's book reserve would have been *had the company reflected on its books the accrual rates requested in rate cases since 1972.* The following tabulation graphically demonstrates that the difference or variation between the calculated depreciation reserve and the book depreciation reserve has occurred since 1971:

ANNUAL DEPRECIATION RATE VARIANCE

Year	*Book Rate* (1)%	*Calculated Rate* (2)%	*Book Over Calculated* (3)%
1971	3.11	3.13	(0.02)
12-31-71			
1972	3.12	2.64	0.48
1973	3.13	2.61	0.52
6-30-73			
1974	3.13	2.61	0.52
1975	3.13	2.59	0.54
2-28-75			
1976	3.13	2.59	0.54
1977	3.13	2.66	0.47
7-31-77			
1978	2.60	2.66	(0.04)
1979	2.63	2.79	(0.17)
9-30-79			
1980	2.71	2.73	(0.02)
12-31-80			
1981	2.71	2.79	(0.08)
1982	2.88	2.81	0.07
12-31-82			

DEPRECIATION RESERVE VARIANCE

Year	*Book 000s* (1)	*Calculated 000s* (2)	*Book Over Calculated 000s* (3)
1971	$21,526	$21,951	$ (425)
12-31-71			
1972			
1973	25,142	20,648	4,494
6-30-73			
1974			
1975	29,153	23,932	5,221
2-28-75			
1976			
1977	35,425	26,009	9,416
7-31-77			
1978			
1979	42,930	32,702	10,228
9-30-79			
1980	48,489	38,401	10,088
12-31-80			
1981	52,361	43,690	8,671
12-31-81			
1982	58,023	49,334	8,689
12-31-82			

The methodology developed and utilized by Mr. Gruber produces an adjusted book depreciation reserve which closely approximates the amount of the book depreciation reserve had the appropriate depreciation expenses, as collected through rates, been booked by the company during the period in question. Penn Power's book depreciation reserve is higher than the calculated reserve for the reason that the company booked higher annual depreciation accruals, during the period in question, than would have been accrued had the company used the annual accruals used in the rate proceeding during this period. The present customers of Penn Power should not be required to pay higher rates based upon this over-accrual. Continued use of the company's calculated depreciation reserve would result in customers being required to pay for depreciation expense which has already been collected from customers under rates approved by this commission since 1971.

Trial staff also proposes that we direct Penn Power to meet with staff and develop a standardized yearly filing for depreciation. Such a filing would include the submission of annual retirement data by account as well as monthly calculations of book depreciation expense and a retirement index by which the book reserve can be monitored. When retirements exceed this index, Penn Power would file an explanation of that account. We will adopt trial staff's proposal.

We concur with the recommendation of the ALJ that trial staff's adjustment to book depreciation reserve in the amount of $8,098,290, as corrected, be adopted, and that the depreciation expense adjustment (reduction) of $241,680 also be adopted. We also will direct the company to meet with the bureau of rates for the purpose of developing a standardized annual depreciation filing.

E. *Cash Working Capital*

Penn Power has claimed a jurisdictional working capital allowance of $19,608,026 consisting of (i) cash needs for operating and maintenance expenses, including taxes, and average prepayments of $4,690,562 (total company); and (ii) fuel inventory, material and supplies, and energy rate deferral costs of $15,596,800 (total company).

The company describes the term working capital as stated in Pittsburgh v Pennsylvania Pub. Utility Commission (1952) 370 Pa 305, 94 PUR NS 353, 355, 356, 88 A2d 59:

"Cash working capital ordinarily is the amount of cash required to operate a utility during the interim between the rendition of service and the receipt of payment therefore [sic]. It is the bloodstream that gives life to the physical plant and facilities of the enterprise. It can readily be seen that, initially, at the commencement of operation, capital supplied by investors must, in order for the company to function, include such working cash in addition to the amount required for physical plant and facilities. Its allowance as an element of fair value for rate-making purposes has been approved by decisions of both the superior and supreme courts of this state and of the appellate courts of other jurisdictions."

1. *Lead-lag Study*

Penn Power's claim for cash required in advance of the receipt of revenue to defray the cost of operating and maintenance expenses was determined from the

same lead-lag study which was utilized in the company's two most recent rate proceedings. That study indicated an average lag in the receipt of revenue of 42.22 days and varying lags in the payment of production power expenses (40.22 days), payroll (11.90 days), and other goods and services (37.43 days). The company claims a billing lag of 7.22 days, the time required to read the meter, process the read, and prepare the bill. Penn Power sends the data to its parent, Ohio Edison, which prepares and mails the bill.

The OCA contends that the company's 7.22-day billing lag period is overstated since the data upon which the billing period is based is over three years old.

Penn Power, in cooperation with Ohio Edison, has installed a new meter reading system called the CIS system. This system was begun in September, 1983, and was expanded to various divisions in October, November, and December, 1983. Although the company's witness Mr. Pazak initially testified that this system will be completed in January, 1984, he later revised this testimony by indicating that full completion and operation of this system would occur at the end of the future test year. The following testimony describes the faster transmission of billing data under the new system.

"There's a new meter reading system known as a Porta Processor. The meter reader carries a walkie-talkie type meter reading device and punches in the number and records it. At night, it gives them the certain signals about each account. At night that is plugged and it's transmitted directly for billing purposes at that point for each [billing] cycle."

OCA witness Eckhaus would reduce the 7.22-day billing lag period to five days, this reduced figure being

essentially based upon a decision of the public utilities commission of Ohio (Case No. 82-1025-EL-AIR) which concluded that, in the case of Ohio Edison, a five-day billing lag period was appropriate based upon the introduction of the subject CIS system.

The ALJ, in discussing this issue, notes that the OCA's proposed billing lag reduction is not based upon any analysis of Penn Power's procedures but rather upon the implementation of the CIS system by Ohio Edison, and concludes that the Ohio Edison case is not, in and of itself, an adequate basis for adopting the OCA adjustment.

We agree with the ALJ that the company is basing its projections on a lead-lag study which is not current. The ALJ also currently concluded that the OCA's adjustment is based primarily upon the testimony of the company's witnesses relative to the installation of the CIS system. Penn Power admits that this CIS system will be essentially installed and in operation by the time the rates in this proceeding are placed in effect. The purpose behind the installation of the CIS system is to reduce the billing lag period. This system will be operational when the rates developed in this proceeding become effective, and we would clearly be remiss were we not to reflect this reduction in the billing lag in our determinations. Accordingly, we concur with the recommendation of the OCA that the billing lag period be reduced from 7.22 days to five days and the revenue lag from 42.22 days to forty days.

2. *Federal Income Tax Lag*

Penn Power's claimed federal income tax payment lag approximates fifty-nine days (58.95), and is based on the statutory estimated tax payment schedule set forth

in current regulations of the Internal Revenue Service. The company also utilized existing, not proposed rates, in developing the tax payment lag.

OCA witness Eckhaus urges that the 59-day payment lag be increased to 174.1 days based upon the actual payments made by the company for the calendar year 1982 federal income tax liability. OCA's essential argument is that the last full year's actual payment experience (1982) should be used to develop the tax payment lag.

Penn Power opposes the OCA adjustment on three grounds. First it argues that Mr. Eckhaus was either unaware of or chose to ignore the fact that the Internal Revenue Service revised its regulations during the past year, and that in 1982 the company was required to pay only 80 per cent of its current year's federal income tax liability by December 15th, the remaining 20 per cent in equal installments on March 15th and June 15th of the following year. Under present IRS regulations, 90 per cent of the current year's tax liability must be paid by December 15th with the remaining 10 per cent payable the following March 15th.

Secondly, the company argues it has substantially revised the basis upon which it estimates its current year's tax liability in order to avoid potential underpayment penalties. Stuart G. McDaniel, senior vice president of Associated Utility Services, Inc., described this change as follows:

"[T]he method by which Penn Power presently estimates its income tax liability is different from that which it employed in 1982 in order to assure compliance with the Safe Harbor Provisions of the Internal Revenue Code and thereby avoid the payment of non-

deductible penalties. In 1982, Penn Power based its April 15, 1982, payment on the actual results of operations for the three months ended March 31, 1982, and budgeted results for the remaining nine months of the calendar year. Similarly, this procedure was followed with respect to subsequent payments on June 15th, September 15th, and December 15th.

"Because of the change in the tax law, which became effective January 1, 1983, Penn Power now bases its installments for April 15th, June 15th, and September 15th on the basis of annualized actual results of operations. For example, the April 15th, 1983, payment was based on the first three months of 1983 annualized without regard to the budget. The change in the method of estimating taxes, along with the acceleration of the payment schedule as a result of new IRS regulations, has accelerated Penn Power's payments to the federal government."

Thirdly, the company argues that it grossly underestimated its federal income tax liability for 1982 when it made the first three installment payments, the basis upon which Mr. Eckhaus developed his recommended 174.1-day payment lag. Mr. McDaniel testified:

"As I mentioned previously, Penn Power's estimated 1982 federal income tax payments were based on a combination of actual results and budgeted data. Significantly, however, the 1982 budget did not include any additional revenues relative to the company's rate application at Docket No. R-821918, which was filed on April 5, 1982. Moreover, even if anticipated revenues had been included in the budget, they would have been eliminated for this purpose, since the company's practice is not to pay taxes in advance on the basis of as-

suming what the commission might or might not award in any given rate case. As it turned out, the 1982 rate case was settled and new rates became effective in September 1982. The increased rate levels materially affected the revenues generated during the fourth quarter of 1982 and, in part, resulted in higher estimated payments in December 1982, March 1983, and June 1983 than would have otherwise been the case."

Under present Internal Revenue Service regulations the company must pay 90 per cent of its tax liability by December 15th, and the remaining 10 per cent by the following March 15th. Penn Power testified that it bases its April 15th, June 15th, and September tax installment payments on the basis of annualized actual operations, thus accelerating the company's tax payments.

Our review of Mr. McDaniel's testimony substantiates the company's contention that the 1982 tax payments, which formed the basis of the OCA's adjustment in the tax payment lag, were grossly underestimated. The 1982 budget did not reflect revenues from increased rates; and although the company testified that it does not as a practice anticipate increased revenues from proposed rates, nevertheless the 1982 tax payments were clearly understated. For this reason, we decline to accept the OCA's proposed lag adjustment which was based upon atypical data.

We have explained our reasoning for rejecting the 174.1 days tax lag payment advocated by the OCA. We are confronted with an issue difficult of resolution for the reason that actual tax payments may vary for numerous reasons beyond the control of the company. We consider it appropriate, under these circumstances,

that the actual income tax regulations payment schedule be utilized. We therefore accept the company's 59-day lag period for federal income tax payments.

F. *Fuel Inventories*

As part of its test-year claims for working capital, Penn Power has included claims for coal and oil inventory during the future test year. Those portions of the company's working capital attributable to coal and oil inventories and materials and supplies were described by Messrs. Pazak and Kauffman and are set forth in detail in the company's Exh 1 (Future). Penn Power contends that the claimed amounts, which are based on projected 13-month average balances, are designed to provide the company with the levels of inventory required to maintain service reliability notwithstanding supply disruptions. The unit prices employed in valuing the claimed quantities of coal and oil reflect the estimated average inventory prices at March 31, 1984, with the exception of that portion of Mansfield coal from the Quarto mine which, consistent with the commission's order at Docket No. R-811510, has been priced out at the "Quarto cap" price.

1. *Coal Inventories*

The OCA submits that both the projected inventory levels and projected future test-year-end prices for coal are overstated and must be adjusted. That adjustment reduces Penn Power's rate base claim from $9,340,471 to $7,991,000. This adjustment has two bases.

First, according to OCA, the inventory level estimation process used by Penn Power is flawed, does not meet the company's conceptual basis for this claim, and therefore produces inventory levels which are too high.

The flaw from OCA's point of view is that the only supply interruptions projected by the company are cold weather interruptions in the transportation of coal, yet larger inventories are projected in several spring and summer months than in several fall and winter months. OCA therefore established a range of tonnage required to keep inventory at a level required to provide service without interruptions and picked the midpoint of that range for each month these ranges were provided by Penn Power.

Second, the inventory prices claimed for valuing the inventory, according to OCA, is also too high, since it is a projected price for 1984; OCA recommends using the last known price submitted by Penn Power for September, 1983.

Penn Power argues that OCA has not provided a true critique of its estimating methodology, but merely developed a different methodology to produce a different result. The company contends that as Mr. Pazak explained:

"Mr. Eckhaus reduces the company's requested coal inventory levels to reflect the midpoints of what he perceives to be appropriate 'ranges.' The ranges which he utilizes, however, were expressly based on the assumption that the company would not experience any kind of supply disruption. Unfortunately, the company cannot rely on such assumptions for planning purposes if it is to continue to provide safe and reliable service. Moreover, it should be noted that, unlike his proposed adjustments to oil inventories, materials and supplies, and prepayment balances, Mr. Eckhaus chose to ignore actual data regarding coal inventories. As a review of the company's response to OCA Interrogatory RR/RB 66

indicates, the average coal balances during the first six months of the future test year substantially exceeded the tonnage levels proposed by Mr. Eckhaus at all three generating facilities in question and in two instances (Sammis No. 7 and Mansfield) actually exceeded the levels claimed by the company."

Mr. Pazak further noted that if Mr. Eckhaus had consistently applied what otherwise appeared to have been his preferred methodology—i.e., a combination of actual and budgeted data—the resulting average monthly coal balances would have been virtually identical to the levels claimed by Penn Power.

Penn Power's future test-year claim is approximately $2.5 million less than its historic experience.

We concur with the recommendation of the ALJ and decline to accept the OCA's adjustment to coal inventory levels. We agree with the company that it is improper to assume that the company will experience no supply interruptions. Furthermore, the actual average coal balances during the first six months of the future test year substantially exceeded the tonnage levels at three generating facilities as advocated by the OCA; and the actual coal balances exceeded the tonnage levels claimed by the company for Sammis No. 7 and for Mansfield generating units.

The ALJ recommends that the actual coal prices for September, 1983, for New Castle ($33,205) and for Sammis No. 7 ($33,947) be used to price coal inventories. The recommendation of the ALJ is based upon evidence which shows that actual coal cost for New Castle and Sammis No. 7 are lower than projected by the company, and the fact that, historically, test-year figures do not indicate a test-year-end increase as

projected by the company. We concur with the recommendation of the ALJ regarding the pricing of coal inventories, and accept the basis for this recommendation.

2. *Oil Inventories*

OCA argues that both the projected oil inventory levels and projected future test-year-end prices for oil are overstated and must be adjusted, and would reduce Penn Power's rate base claim from $153,763 to $144,000. Penn Power's historic valuation of these same inventories was $175,801, or $18,000 lower than the historic cost level.

Penn Power projects that it will maintain the same level of oil inventories at each of three plants or units in each month during the future test year. The company values this inventory at its projected purchase cost per gallon at each plant for the last month of the future test year. At all three of these units, New Castle, Sammis No. 7, and New Castle (EMD), the price is at, or is next to, the highest projected purchase price. At the fourth plant, Mansfield, the price is the lowest purchase price.

Actual experience shows that oil inventories at these plants vary from month to month. In many instances, these fluctuations are quite large. Historic and actual prices also show variations in price, particularly for light-off fuel at New Castle and Sammis No. 7.

OCA has calculated an average level of inventory based on the actual test-year experience, except in the case of Mansfield which includes what OCA considers unexplained increases, and a valuation of it based on the last known monthly actual purchase prices for oil at each unit, except for Sammis No. 7, where this price is higher than previous months for unexplained reasons.

The ALJ concluded that the OCA had not demonstrated that its estimating technique was in any way superior to or produces a more appropriate result than Penn Power's. We concur with the conclusion and find the company's claim for oil inventories acceptable, being based upon reasonable projected purchase prices for oil at each plant for the last month of the future test year.

G. *Plant or Land Held for Future Use*

The company claims $842,074, for land held for future use, representing Penn Power's investment in land held for future use as transmission line and substation sites. The location of each such site, as well as the anticipated in-service date for the underlying project, are set forth in PPC Exh I, Schedule I-A-14. As noted on this schedule, and described by Mr. Pazak, the claim involves five rights of way with in-service dates prior to 1993.

OCA's witness Eckhaus has proposed removing this claimed amount entirely from rate base. His proposal has two bases. First, he argues that plant (including land) held for future use is indistinguishable from CWIP, and that it should be allowed to accrue carrying costs and then these costs and the plant be included in rate base when the plant becomes used and useful.

Second, OCA argues that § 1315 of the Public Utility Code, 66 Pa.C.S. § 1315, signed into law on December 30, 1982, when read in conjunction with § 102 of the code, 66 Pa.C.S. § 102, requires that no utility property, including real property, should be considered used and useful until it is actually used in providing present utility service. The land upon which this claim is based will not be used in the future test year, and

therefore OCA contends that the entire claim should be disallowed.

Penn Power argues that the claim should be allowed because it is uncontested that all of the sites which the company had requested meet the two-part test established by the commission; i.e., each is held under a definite plan for use in the company's future electric operations and will be in service within the next ten years. Penn Power has presented evidence which establishes that it has met the two-part test as described in Pennsylvania Pub. Utility Commission v Philadelphia Electric Co. (1981) 55 Pa PUC 78, 87, 88, 42 PUR4th 475, 485, wherein we stated:

"Even were we disposed to change our policy at this time and based upon this record, our test year for the inclusion of land held for future use is comprised of two criteria and shall not be modified. As stated in Pennsylvania Pub. Utility Commission v Pennsylvania Electric Co. (1976) R.I.D. 172:

" 'It is the current policy of the Pennsylvania Public Utility Commission to allow the inclusion of land held for future use in rate base (1) *when definite plans are available and* (2) *said utilization will occur within a reasonable time.* The commission has earmarked a reasonable time in recent rate decisions as being up to ten years.' "

The company has shown a definite plan for the use of this property and that the property will be in use within the ten-year period. The "policy" stated above is based upon our conclusion that the acquisition of transmission line rights of way and land for substation sites must frequently, and of necessity, be acquired substantially prior to actual construction of the facilities which

eventually will occupy the land. Customers of Penn Power actually benefit from the acquisition of such land and land rights prior to the commencement of actual construction since if these land rights are acquired immediately prior to construction, the acquisition costs may be higher, and in many instances, the land sites may not be available for acquisition at a later date. We of course do not condone the inclusion of the investment in land and land rights for which there is not definite plan for use within a reasonable period of time.

Turning to the OCA's argument that § 1315 of the Public Utility Code precludes the inclusion of property, including real property, as used and useful until actually placed in service, we repeat here our contrary legal conclusion as stated in Pennsylvania Pub. Utility Commission v Metropolitan Edison Co. Docket No. R-822249, Oct. 9, 1983:

"While the cost of unimproved land or land rights might be considered to be a component of 'the cost of construction of a facility,' as that term is used in the statute, the subject of plant held for future use, has, historically, been a subject separate and distinct from that of construction work in progress. We believe that it would be an unreasonable reading of the statute, to apply the definition of used and useful in such a manner as to result in a reversal of commission practice regarding plant held for future use, in the face of legislative silence on this separate and distinct regulatory subject." See also Pennsylvania Pub. Utility Commission v Pennsylvania Power & Light Co. (1983) 55 PUR4th 185; Pennsylvania Pub. Utility Commission v Philadelphia Electric Co. Docket No. R-822291, Nov. 23, 1983; Pennsylvania Pub. Utility Commission v Pennsylvania Electric Co. Docket No. R-822250, Oct. 19, 1983.

The company's claim for land held for future use is accepted.

IV. *Fair Rate of Return*

In reaching a determination of a fair rate of return for the company in this proceeding, we will first review the legal standards which we are required to follow.

Penn Power, a public utility, is entitled to an opportunity to earn a fair rate of return. See Pennsylvania Gas & Water Co. v Pennsylvania Pub. Utility Commission (1975) 19 Pa Cmwlth 214, 341 A2d 239; Riverton Consol. Water Co. v Pennsylvania Pub. Utility Commission (1958) 186 Pa Super Ct 1, 24 PUR3d 9, 140 A2d 114. The return authorized must not be confiscatory, and must be based upon evidence presented. See Pittsburgh v Pennsylvania Pub. Utility Commission (1949) 165 Pa Super Ct 519, 82 PUR NS 572, 69 A2d 844.

Among the factors to be considered in determining a fair rate of return are: the earnings which are necessary to assure confidence in the financial integrity of the utility and to maintain its credit standing; the payment of dividends and interest; the business and financial risks; and the circumstances attending the origin, development, and operation of the business. Pennsylvania Gas & Water Co. v Pennsylvania Pub. Utility Commission (1956) 182 Pa Super Ct 35, 125 A2d 603.

Although the cost of capital and fair rate of return are not always synonymous, cost of capital is one of the important bases upon which a fair rate of return is determined. Lower Paxton Township v Pennsylvania Pub. Utility Commission (1974) 13 Pa Cmwlth 135, 317 A2d 917. The generally accepted method of arriving at

a fair rate of return is the cost of capital approach. The rate-making authority examines the utility's capital structure to identify the sources of the utility's capital. It then ascertains the cost of each component: the cost of debt, determined essentially by the annual interest requirements of the utility's bonds; the cost of preferred stock; and the cost of common equity, determined by the return required to sell such equity stock upon reasonable terms in the market. Pennsylvania Pub. Utility Commission v Bell Teleph. Co. of Pennsylvania, R-811819, March 8, 1983.

The constitutional requirements applicable to the derivation of a fair rate of return are set forth in Bluefield Water Works & Improv. Co. v West Virginia Pub. Service Commission, 262 US 679, PUR1923D 11, 67 L Ed 1176, 43 S Ct 675, and in Federal Power Commission v Hope Nat. Gas Co. (1944) 320 US 591, 51 PUR NS 193, 88 L Ed 333, 64 S Ct 281. In Bluefield the United States Supreme Court stated (PUR1923D at pp. 18, 20, 21):

". . . Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the service are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility of its property in violation of the Fourteenth Amendment.

". . . A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has

no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the utility and should be adequate under efficient and economical management to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties."

In Hope, the United States Supreme Court stated (51 PUR NS at pp. 200, 201):

"The rate-making process, under the act—i.e., the fixing of just and reasonable rates—involves a balancing of the investor and the consumer interest. . . . Regulation does not insure that the business shall produce net revenues. But such considerations aside, the investor interest has legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital cost of the business. These include services on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. The return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital."

Having stated the legal standards which apply to our determination of a fair rate of return, we will now discuss the evidence of record relative to this issue.

We quote, with our concurrence, the following statement of ALJ Turner concerning our enunciated goal, in setting a fair rate of return, of achieving a proper

balance between the conflicting interests of the stockholders and the ratepayers:

"The commission has consistently found it worthwhile to reiterate that its goal in setting a rate of return is to be fair to the stockholders, and fair to the ratepayers, and to achieve proper balance between these two conflicting interests before launching into any analysis and valuation of varying methods presented in testimony. In addition, it has noted that the plethora of methodologies and variations thereof, the variety of source data, and the diversity of the achieved results, is almost overwhelming. A discussion of each facet of each methodology of each witness and comments upon the appropriateness of the data sources each has utilized, is impossible, and I add, would contribute significantly to the regulatory process. As the commission has discussed from time to time in various opinion and orders, each of the methods presented in these proceedings have inherent weaknesses and infirmities, with the consequence that there is probably no conclusion of any witness which is capable of being adopted without modification or adjustment."

A. *Capital Structure*

All parties accept the company's proposed capital structure for the future test year ending March 31, 1984, consisting of 51.8 per cent long-term debt, 13.9 per cent preferred stock, and 34.3 per cent common equity, which we find acceptable.

B. *Cost of Long-term Debt*

All parties accept the embedded long-term debt cost rate of 10.25 per cent as shown by Mr. Hanley. We find this 10.25 per cent cost rate for long-term debt acceptable.

C. *Cost of Preferred Stock*

All parties accept the embedded preferred stock cost rate of 9.49 per cent as shown by Mr. Hanley. We find this 9.49 per cent cost for preferred stock acceptable.

D. *Cost of Equity*

We are confronted with the normal array of methodologies and calculations of the various parties in support of each parties' recommended cost of equity. The following tabulation summarizes the recommended cost of equity, and the methodology utilized by the parties in developing the recommended equity cost rate:

Methodology	*Penn Power (Hanley)* (1) %	*Staff (O'Donnell)* (2) %	*OCA (Woolridge)* (3) %
Discounted Cash Flow	16.6	14.94-16.14	14.8
Risk Premium	16.9	14.3	14.8
Earnings-price Ratio	17.3	12.17-14.29	14.27
Earnings-net Proceeds	19.1		
Capital Asset Pricing Model	16.4		

E. *Summary of Methodologies of Various Parties*

Frank J. Hanley, senior vice president of Associated Utility Services, Inc. presented testimony in support of a cost of common equity of 17 per cent. Mr. Hanley's recommendation was derived primarily from a consideration of the discounted cash-flow analysis (DCF)—16.6 per cent, and risk premium analysis—16.9 per cent. He also considered, in order of significance, earnings-price ratios (E/P)—17.3 per cent, earnings-net proceeds (E/NP)—19.1 per cent, and the capital asset pricing model (CAPM)—16.4 per cent.

All of the company's stock is owned by Ohio Edison. Mr. Hanley studied financial data for two barometer

groups, Moody's 24 utilities, and 11 Baa-rated operating electric companies listed by Moody's Investors Service, Inc. This witness, however, placed the greatest emphasis on data for the 11 Baa-rated electric utilities for the reason, in his view, that their risk level is most similar to that of Penn Power.

Mr. Hanley reviewed financial data for the barometer companies for the period 1978-82 and spot data for 1983, and also considered near-term projections. This witness recommends use of immediate past and projected near-term data as being the information used by investors in making decisions and because this information provides a realistic view of investor expectations for the approximate 12- to 18-month period during which the rates in this proceeding can be expected to be in effect.

Trial staff, through its witness Andrew R. O'Donnell, commission financial analyst, recommended a common equity cost rate of 15.25 per cent. Mr. O'Donnell's equity cost recommendation was based upon a DCF analysis and an E/P ratio analysis[4] for a barometer group of three operating electric companies, for Moody's 24 public utilities, and for Ohio Edison.

Mr. O'Donnell analyzed financial data for American Electric Power Company, Duquesne Light Company, and Toledo Edison Company (the three electric companies) which he considered a representative group of companies having risks similar to Penn Power, having

[4]Comparison Group	*DCF*	*September 30, 1983 Earnings-price*
	(1)%	(2)%
Ohio Edison	14.94	14.29
Barometer Group of Three	15.00	12.17
Moody's 24	16.14	14.18

met his criteria of (i) being publicly traded companies with electric operating revenues greater than 95 per cent of all revenues; (ii) having an expected fuel mix which contained both nuclear and coal, with a combined total of approximately 85 per cent or more; and (iii) having a Moody's bond rating of A3-Baa3.

This witness placed greater emphasis on market data of Ohio Edison and the barometer group of three electric utilities than on Moody's 24.

Mr. O'Donnell considered Ohio Edison appropriate for comparability purposes since Penn Power and Ohio Edison possessed similar management, Moody's credit ratings, fuel generation mix, revenue distribution, capital structure, and for the reason that both companies are members of CAPCO, and Ohio Edison owns all the common stock of Penn Power. This witness considered his group of three electric utilities as being comparable with Penn Power, having similarities in service territory, effective tax rate, revenue distribution, coverage ratio, and capital structure.

Mr. O'Donnell also testified that a comparative analysis of the Moody's 24 revealed similarities with Penn Power as to revenue distribution, effective tax rate, and quality of earnings but substantial differences in fuel mix, credit ratings, electric revenues to total revenues, fixed charge coverage, and service territory.

The OCA presented Dr. J. Randall Woolridge as its expert rate of return witness, who recommended a common equity cost rate of 14.8 per cent based primarily on the DCF methodology. He also used the risk premium methodology (14.3-14.8 per cent) as a check. While expressing some reservations concerning the makeup of

the 11 Baa-rated electric utilities for comparative purposes, he did utilize data for this group.

F. *Discounted Cash-flow Methodology*

In developing a cost of equity under the DCF methodology, Mr. Hanley calculated the average dividend yield for his 11 barometer companies for the twelve months ended October 31, 1983, and averaged that figure with the spot dividend yield calculated on November 22, 1983, which produced a mean and median yield of 10.8 per cent. He then adjusted the yield of 10.8 per cent to take into account the periodic payment and expected growth of dividends and developed an adjusted yield of 11.1 per cent.

Mr. Hanley, in the development of his growth factor, reviewed the average five-year compound growth rate in earnings for his barometer group, which is 4.7 per cent. For dividends, this growth rate is 6.7 per cent. In light of these figures and recent commission decisions, Mr. Hanley concluded that a growth rate of 5.5 per cent is appropriate, reasonable, and even conservative. His DCF derived cost rate for equity is 16.6 per cent. In reaching this conclusion, Mr. Hanley also reviewed the recent historic growth of dividends and earnings averaged together and the average of historic and near-term projected growth of dividends. In his opinion, these averages support his judgement.

Trial staff witness O'Donnell applied the same method as the company for calculation of the adjusted dividend yield, giving effect to one-half the expected next-period growth rate. Mr. O'Donnell performed a comparative analysis of dividend yields for periods of twenty, ten, five, and three years, and at September 30, 1983, for Ohio Edison and his three comparison groups.

He then computed a mean yield and one standard deviation in excess of the yield for each, which revealed current dividend yields as consistently greater than one standard deviation in excess of the mean. The results are set forth in the following table:

	Mean Yield + One St. Dev.	*Current Yield (September 30, 1983)*
Ohio Edison Company	11.57	12.30
Barometer Group of Three Electrics	11.20	11.83
Moody's 24	10.30	10.40

Mr. O'Donnell concluded that the market trend is moving from a period of under valuation to proper valuation and concluded that actual yields should be lower in the future.

In developing a growth factor, Mr. O'Donnell first utilized Value Line projected growth rates (1980-82, 1986-88) as derived for the group of Moody's 24, barometer group of three, and Ohio Edison.

Those growth rates are as follows:

	Value Line's 1980-82 to 1986-88	
	DPS (%)	*EPS (%)*
Moody's 24	5.5	5.5
Barometer Group of Three	3.0	4.0
Ohio Edison	2.5	5.0

Mr. O'Donnell analyzed the past ten-year (1973-82) growth rates in earnings and dividends per share for each of his three comparison groups. He further averaged the ten-year historic dividend growth rates with the Value Line dividend growth rate projections to achieve an average dividend per share growth rate. Trial staff contends that the dividend yields and growth rate projections support the reasonableness of the 15.25

per cent equity cost rate recommendation; however, trial staff did not make a specific equity cost rate recommendation under the DCF methodology.

Trial staff states that this particular analysis of both historic and projected growth rates, while not incorporated into the DCF analysis, was done to demonstrate that the results of the use of an historic/projected average do not differ significantly from the use of the projected growth rate alone, as was utilized in Mr. O'Donnell's DCF analysis.

Mr. Woolridge developed the same 10.8 per cent dividend yield recommended by the company but made no further adjustment as did Mr. Hanley.

Dr. Woolridge reviewed fifteen years compounded annual growth rates for the company's barometer group of 11 electric companies. He then selected the mean (4.8 per cent), median (3.7 per cent), and mode (3.7 per cent) of these figures and judgmentally arrived at a growth rate of 4 per cent. He states that this method and result smooth out two aberrationally high recent years, included in Mr. Hanley's calculation, where the compound growth rate was 13.3 per cent and 9.1 per cent, and also recognizes the recent trend toward increasing growth rates. His DCF derived cost rate for common equity is 14.8 per cent.

G. *Risk Premium Methodology*

Mr. Hanley developed an indicated equity cost rate of 16.9 per cent under the risk premium methodology, based upon a cost rate of 11.9 per cent for new Aa-rated bonds, plus a one per cent spread between Aaa-rated bonds and Baa-rated bonds, plus a 4 per cent equity risk premium. Mr. Hanley is of the opinion that his

bond rate includes a real or risk-free return, and an expectation of long-term inflation rates.

Mr. Hanley added one per cent to the basic 11.9 per cent bond rate (based on projections for utility bond rates by Value Line and forty-five economists) to compensate for Penn Power's Baa3 bond rating, and developed a risk premium based on the 1982 Ibbotson and Sinquefield study, *Stocks, Bonds, Bills and Inflation Past and Future* (I&S study).

OCA does not recommend use of the risk premium methodology as a primary determination for an equity cost rate; however, Dr. Woolridge did perform a risk premium analysis as a check on his DCF determination.

Dr. Woolridge used one to one and one-half year U.S. Treasury obligations, rather than utility bonds, as the basis for his riskless investment component, since in his opinion this is the best approximation of a risk-free investment. The riskless rate is in the 9.5 per cent-10 per cent range. Dr. Woolridge then developed an equity risk premium of 4.8 per cent based on his study showing risk premium ranging from 4-5 per cent. He used the high end of the range to account for Penn Power's Baa bond rating. Dr. Woolridge's equity cost rate under the risk premium methodology is an exact confirmation of his DCF calculation of 14.8 per cent.

Mr. O'Donnell utilized Mr. Hanley's 6.2 per cent current real interest rate as being reflective of past, not present, interest rates. Mr. O'Donnell testified that the general consensus of economic forecasting agencies is that inflation will stabilize in the 4-6 per cent range through 1984.

H. *Discussion and Conclusion Re: Cost of Common Equity*

1. *Discounted Cash-flow Methodology*

Mr. Hanley calculated the average dividend yield for his 11 barometer companies for the twelve months ended October 31, 1983, and averaged that figure with the spot dividend yield calculated on November 22, 1983, which produced an indicated yield of 10.8 per cent.[5] We find this yield recommendation acceptable since it is based upon a twelve months' average which tends to smooth any abnormal yields at a particular point in time. We do not fault consideration also of a spot yield, provided the spot yield does not reflect the sole basis for a yield computation.

We do not however agree with Mr. Hanley that the yield factor must be adjusted to take into account the periodic payment and expected growth of dividends. This adjustment is based upon the "Gordon" equation which increases the dividend yield by an estimated amount to reflect the quarterly payment schedule of dividends and for growth in dividends during the first year the stock is held. We agree with Dr. Woolridge that the growth factor in the DCF formula (the "g" factor) incorporates a consideration of growth, and Mr. Hanley's yield adjustment which adds one half the growth rate in dividends in the next twelve months amounts to a double accounting for the next year's growth. Accordingly, we will use a yield factor of 10.8 per cent in our DCF calculation of the equity cost rate.

Turning to the growth factor in the DCF formula, Mr. Hanley recommended a 5.5 per cent factor, which was based upon the average five-year compound growth

[5] The same average yield calculated by OCA's witness Dr. Woolridge.

rate in earnings for his barometer group (4.7 per cent) and a growth rate in dividends (6.7 per cent).

Trial staff witness O'Donnell analyzed earnings and dividends growth rates for his three comparison groups for the past ten years. He then averaged the ten-year historic dividend growth rates with the Value Line dividend growth rate. Dr. Woolridge faults Mr. Hanley's growth recommendation for the reason, inter alia, that he places undue reliance on dividend growth compared to earnings growth. Although we have not consistently relied solely upon earnings growth in the DCF computations, we continue to be of the view that earnings growth should be given primary consideration for the reason that dividends are influenced by pay out decisions, and over the long term, dividends should track earnings. Having reviewed the recommendations of the parties, and giving consideration to the above conclusions regarding dividends, we conclude that a proper growth factor is 4.9 per cent-5 per cent. Thus, under the DCF methodology, we find an indicated equity cost rate of 15.7 per cent-15.8 per cent.

2. *Risk Premium Methodology*

Mr. Hanley based his risk premium calculations upon a cost rate of 11.9 per cent for new Aaa-rated bonds, plus a one per cent spread between Aaa-rated bonds and Baa-rated bonds plus a 4 per cent equity risk premium.

Dr. Woolridge utilized one to one and one-half year U. S. Treasury obligations as representive of a risk-free investment. His risk-free rate is in the range of 9.5 per cent-10 per cent. He recommended use of the upper end of this range to account for Penn Power's lower bond rating. This witness developed an equity risk premium of 4.8 per cent.

Trial staff determined an indicated real interest rate of 4.4 per cent-6.2 per cent, an inflation expectation factor of 4.8 per cent, an equity risk premium of 3.2 per cent, and a one per cent adjustment to reflect Penn Power's lower bond rating.

Mr. Hanley's 11.9 per cent cost for Aaa-rated bonds represents a long-term investment which, in our view, is not truly reflective of a risk-free investment over the period the rates determined in this proceeding will be in effect. On the other hand, we find OCA's recommended risk-free cost rate of 9 per cent-10 per cent to be on the low side for the reason that it does not specifically contain any factor reflective of Penn Power's lower bond rating. We concluded that a risk-free cost of [sic] rate of 11 per cent reflects a proper risk-free rate, after considering the infirmities mentioned in the company's and OCA analysis.

We further conclude that an equity risk premium of 5 per cent is appropriate, being at the upper range of Dr. Woolridge's recommendation. We conclude, that a cost of equity under the risk premium methodology of approximately 16 per cent is reasonable.

We determine a fair and reasonable cost rate for common equity in this proceeding to be in the range of 15.7 per cent, our determination under the DCF methodology, and 16 per cent under the risk premium methodology. For our return calculations, we will use a specific equity cost rate of 15.72 per cent.

3. *Fair Rate of Return*

Following is a summary of our fair rate of return finding for Penn Power:

	Capital Structure (1) %	*Cost Rate* (2) %	*Weighted Cost* (3) %
Debt	51.8	10.25	5.31
Preferred Stock	13.9	9.49	1.32
Common Equity	34.3	15.72	5.39
	100.0		12.02

V. *Revenues*

The company's claimed pro forma revenue levels were based on the future test year. Company witness Pazak described how Penn Power's revenue forecast was developed. The development was explained by the company in its main brief:

"Consistent with commission practice, the estimated future test-year figures were then adjusted to eliminate revenues recovered under Penn Power's levelized energy cost rate (LECR) and under the state tax adjustment clause (STAC).

"Estimated revenues have also been adjusted for residential and commercial customer load growth to reflect sales levels at March 31, 1984. As explained by David M. Headings, senior rate and statistical analyst for the company, this adjustment, which increases operating revenues by $779,800, annualizes the effect of changes both in the number of customers and in the usage of existing customers and was based on the three-year averaging method repeatedly approved by the commission in the past.

"Finally, the company has made an adjustment to annualize, at test-year-end prices and quantities, rental

income to be derived from sales of capacity to Ohio Edison. In its initial filing, Penn Power estimated that during 1984 it would sell to Ohio Edison 74 megawatts from Beaver Valley Unit No. 1 and five megawatts from Sammis Unit No. 7. Based on subsequent information, Mr. Pazak later projected that the company will only sell 49 megawatts of capacity from Beaver Valley Unit No. 1 to its parent. As a result of that revision, future test-year revenues have been reduced by $2,439,000.

"[1]As noted by Mr. Headings, it was not necessary to adjust either industrial or streetlighting revenues."

Initially, the OCA proposed an adjustment to the company's original pro forma operating revenue claim to reflect the reduction from 79 megawatts to 49 megawatts in the amount of capacity estimated to be sold to Ohio Edison. As indicated above, the effect of that change was incorporated in Penn Power's final accounting presentation and, accordingly, the data does not require further revision.

Through the testimony of witness Eckhaus, the OCA also recommends an adjustment to reflect what it considers to be the appropriate rate-making treatment of certain capacity charge revenues associated with the sale of 28 megawatts to General Public Utilities (GPU) and 21 megawatts to Potomac Electric Power Company (PEPCO). The OCA argues that the sale of 49 megawatts to Ohio Edison, as referred to above, is considered to be a firm sale and includes capacity and energy charges. Furthermore, the OCA asserts that the PEPCO and GPU sales are also considered firm sales. While the capacity charge revenues from Ohio Edison sale are reflected in base rates under rent from electric

property, and energy charges are included in the levelized energy cost rate (LECR), both the energy and capacity charges of the PEPCO and GPU sales are credited to the LECR.

The OCA noted that the dissimilar treatment with respect to capacity charges is the result of the settlement of Penn Power's last base rate proceeding at R-821918, where capacity sales to PEPCO and GPU were only contemplated. According to OCA, sales have occurred and proper rate making requires that the capacity charges for the two contracts be recognized in base rates. In the opinion of the OCA, this inclusion of capacity payments in base rates, with the continued reflection of energy charges in the energy cost rates, provides a better balance of the benefit of the sales between ratepayer classes.

The company first observes that the capacity charges are not contractually frozen at the 1984 rate levels, and that it is conceivable that PEPCO and/or GPU will not schedule their full contract entitlements every week of the year due to physical or contractual transmission line limitations. With respect to such limitations, the company states that PEPCO and GPU are not required to make capacity charge payments under such circumstances, while Ohio Edison is obligated to make fixed charge payments.

Finally, Penn Power argues that the OCA's proposed adjustment is inconsistent with its rate design philosophy of encouraging its customers to improve their load factors and, if adopted, would detrimentally affect large industrial users who use a much larger number of kilowatt-hours compared to other customer classes.

In response, the OCA maintains that there is little danger of low estimates since the capacity charges under the PEPCO and GPU contracts increase from year to year. Further, the OCA considers physical or transmission line limitations unlikely to occur. With respect to the detrimental effect on large industrial users, the OCA argues, conversely, that these customers unduly receive most of the cost reductive benefits through the energy cost rate.

The ALJ was not persuaded by the company's arguments that GPU and/or PEPCO might not schedule full contract entitlements. The ALJ considered such a scenario speculative and considered the sales to be firm sales as are the Ohio Edison sales. Further, the ALJ found that a general reduction in base rates will benefit all customers. Then, after noting the company's argument that capacity sales will not remain fixed at the 1984 level, the ALJ reasoned that the OCA could not properly have relied on sales levels after 1984 in this base rate proceeding and instructed the company in its next rate filing to include in its revenue calculations the appropriate level of capacity sales for PEPCO and GPU.

The ALJ recommended that the commission adopt the OCA's adjusted amount for rent from electric property of $11,778,418 (13,352,418–1,574,000) rather than the $10, 912,518 indicated in PPC Exh 1 (Future), second revised, and directed Penn Power to file an amendment to its LECR removing the appropriate amounts from it for the LECR year beginning April 1, 1984.

Penn Power filed an exception to the ALJ's recommendation, and, for the most part, reiterated arguments previously made. However, the company did interject

recent commission action which it considers to be of precedental value. In Pennsylvania Pub. Utility Commission v Pennsylvania Power & Light Co. (1983) 55 PUR4th 185, 237, the company argues that the commission held that the concept of a utility "guaranteeing" savings is inconsistent with fundamental rate-making principles and destroys the "raison d'etre" of the LECR.[6] The OCA, in reply, asserts that the company has confused capacity charges and energy charges since capacity charges have to be made regardless of energy sales except under limited circumstances.

Despite failing to address this issue up to this point in the proceeding, staff filed an exception to the ALJ's adoption of the OCA's proposed adjustment. By crediting GPU and PEPCO capacity charge revenues to base rates, staff notes that the net effect is to reduce the company's retail revenues by $1,574,000.

Staff maintains that current commission policy encourages LECR treatment of all off-system sales by Pennsylvania utilities including capacity charges. We consider staff's interpretation of current commission policy regarding treatment of capacity charges to be on point. As recognized by staff, we accorded LECR treatment to capacity charges in Pennsylvania Pub. Utility Commission v West Penn Power Co. R-811836, July 23, 1982, wherein we stated (p. 6):

"Turning to the proposal of West Penn that the F factor in the ECR be revised to remove from base rates, and include in the ECR, the net revenues received from off-system sales to other electric utilities, we find such proposal to be in the public interest. This commission

[6]At issue was $186 million of energy savings projected to be generated by Susquehanna Unit No. 1.

has, in prior rate proceedings of West Penn, been confronted with the issue of an appropriate level for off-system sales to be used in determining the level of allowable revenues. This decision has of necessity been based upon an evaluation of prior off-system sales, and estimated future sales; and a high degree of judgment was used in determining an appropriate level for these sales. West Penn now proposes to pass through to its customers the actual net revenues it will receive in the future from these sales. This removes the uncertainty which has in the past been associated with this issue, and West Penn's proposal will pass the benefit from these sales directly on to its customers, a proposal which is in the public interest. West Penn's testimony and exhibit, regarding the off-system sales contain estimates of sales in the range of $33.7–$42.3 million in 1983 and $24.5–$33 million in 1984. The company anticipates that these sales will actually be higher; and a substantial amount of these sales are under contract with other electric utilities."

By reflecting actual net revenues from off-system sales in the LECR, we were persuaded that the veil of "uncertainty" surrounding this issue had been removed. In fact, we considered such a proposal to be in the "public interest."

According to the OCA, its proposed adjustment reflects the appropriate rate-making treatment of "certain" capacity charge revenues from GPU and PEPCO off-system sales. The OCA considers these sales to be firm sales.

We have reviewed the pertinent testimony and the actual contracts. While it is certain that capacity payments have been received and will be received by

the company in the future, the evidence presented reveals an "uncertainty" with respect to an appropriate level of sales and attendant capacity charges which will be achieved. As indicated in company witness Pazak's testimony, and the actual contractual language, it is conceivable that GPU and/or PEPCO will be unable to schedule their full contract requirements every week of the year, due to physical or contractual limitations. Furthermore, it has also been established that the GPU and PEPCO capacity charge rates will only apply in 1984 and, thereafter, increase from year to year. The company points out, and we agree, that base rate treatment of these charges may understate or significantly overstate the revenues which will be generated in the future. For these reasons, we consider it appropriate to adopt an approach which eliminates the guesswork involved in estimating off-system sales and capacity charges. The utilization of the ECR mechanism to track these revenues will accomplish the desired result. Finally, we disagree with the OCA's view that the inclusion of these capacity charges in base rates provide a better balance of the benefits between ratepayer classes. Since large industrial users make up a disproportionately higher percentage of the company's sales base, we fail to discern how the OCA's proposal is equitable.

Based on the foregoing, we shall grant the company's exception and adopt, for our rate-making purposes, Penn Power's adjusted future test-year revenue. Accordingly, the OCA's proposed adjustment is hereby rejected.

VI. *Expenses and Taxes*

A. *Operating and Maintenance Expenses*

The operating and maintenance expense level claimed by the company for the twelve months ending

March 31, 1984, is $86,837,275. Various expense claims have been contested by staff and the OCA, which are addressed below.

1. *Salaries, Wages and Fringe Benefits*

a. *Level of Employees*

Penn Power estimated that it would have 1,901 employees on its payroll at March 31, 1984, which represents an anticipated increase of twenty-nine employees, or approximately 1.5 per cent over the experienced historic test-year-end level of 1,872.

Staff recommends a downward adjustment of expenses claimed by the company for employees budgeted but not yet hired in the amount of $386,164, as adjusted for Pennsylvania jurisdictional purposes. According to staff, the proposed adjustment is based on the company's history of budgeting for employees in excess of those actually employed.[7]

Staff's description of witness Kalbarczyk's calculation is contained in its main brief and provides as follows:

"In computing his adjustment, Mr. Kalbarczyk utilized the company employee level of March 31, 1983, of 1,872 which represented 98.47 per cent of the budgeted number of 1,902 for that date. This number exceeded by fourteen the actual number of employees at September 30, 1983, of 1,858, thus allowing the company a margin for seasonal and timing differences associated with employees levels. Mr. Kalbarczyk then applied that percentage to a total of Penn Power wages and

[7]Staff states that the company's answers to interrogatories indicated a past and current trend of failing to reach hiring goals when comparing budgeted to actual numbers for the period March 31, 1981, to March 31, 1983.

salaries for the future test year of $27,773,120, to derive a staff proposed allowance for wages and salaries of $27,337,305, a reduction of $438,815. An additional amount of $70,368 was then added to the above final figure, representing the 16.036 per cent of wages and salaries allocable to employee benefits, to arrive at a total adjustment of $509,183. Mr. Kalbarczyk then applied the company allocation factor for operations and maintenance expenses of 79 per cent to derive his recommended adjustment of $402,255 (as reduced to $386,164 for Pennsylvania jurisdiction purposes)."

In support of this adjustment, staff states that company witness Kauffman acknowledged that actual hiring had lagged behind estimated hiring and that trend continued insofar as the future test year was concerned.

The OCA has presented the same arguments as staff in support of an adjustment and undertook the same process in developing its proposed disallowance. However, while staff witness Kalbarczyk's utilized an actual to budgeted ratio of 98.47 per cent, OGA witness Eckhaus employed a ratio of 97.8 per cent, which was based on an average for the past three years, and thereby arrived at a higher indicated adjustment of approximately $458,200 ($580,000 × 79 per cent).

The company first argues that its failure to achieve past budgeted employee levels does not necessarily suggest that the same will hold true in the future. Further, Penn Power argues that the actual number of employees has continued to grow and the economy has improved. Therefore, the company considers it entirely possible that it will reach the estimated level of 1,901 employees by March 31, 1984.

Finally, the company contends that the methodologies employed by staff and the OCA are flawed in several respects. First, the company contends that it is unrealistic to assume that all employees budgeted but not hired would be compensated at the average wage level of all existing company personnel. Secondly, while the ratios developed by staff witness Kalbarczyk and OCA witness Eckhaus were based on employee levels which included all of the workers at the Bruce Mansfield plant, the payroll figures to which they were applied only reflected the company's proportionate ownership share of the costs attributable to that facility. Thirdly, the company maintains that there is an overlap between these adjustments and certain proposals of staff and the OCA in the area of steam power maintenance expense.

Responding to a staff interrogatory, the company also presented a specific analysis of budgeted versus actual employees at the spot date September 30, 1983. Company witness Kauffman calculated that the expense attributable to budgeted but not as yet hired employees approximated $336,000, after application of the 79 per cent allocation factor.

In the event that an adjustment is deemed appropriate, the company asserts that it should not exceed $272,000, which equals the maximum potential cost savings of $336,000 less the additional expense of $64,000, which is attributable to the higher than anticipated wage increase received by the employees at Beaver Valley Unit No. 1.[8]

In its reply brief, staff argues that its utilization of the 98.42 per cent ratio of actual to budgeted employees

[8]According to the company, it underestimated the wage increase costs which it will incur as a coowner of Beaver Valley Unit No. 1.

accurately considers Penn Power's share of the Bruce Mansfield plant.

The ALJ first dismissed the company's arguments that the number of employees has increased and that given this upward trend and an improving economy the company may reach its budgeted level. The ALJ considered this argument speculative, not supported by any evidence of an improving economy in its service territory, and in conflict with the company's own testimony regarding implementation of a hiring freeze and/or cost cutting measures.

Further, the ALJ found that staff had substantiated its contention that its ratio of 98.42 per cent was derived with or without the Bruce Mansfield plant employees.[9]

Finally, the ALJ determined that the company's cost saving figure of $336,000 cannot be substituted for the adjustments proposed. The ALJ reasoned that the calculation did not take into consideration fringe benefits and the final figure utilized was not projected to the future test-year levels.

In the opinion of the ALJ, staff's adjustment represented an appropriate projection of the company's employment future. Accordingly, the ALJ recommended the adoption of staff's proposed reduction of this expense by $386,164.

The company and the OCA have excepted to the recommendation. It appears that the company has conceded that its actual level of employees will not reach the budgeted level. However, the company opposes the amount of the disallowance recommended by the ALJ.

[9]According to the ALJ, the OCA had not demonstrated similarly that the Bruce Mansfield plant adjustment would produce no impact.

The company has now taken the position that if an adjustment is deemed appropriate, it should not exceed $325,881 (or $312,846 on a Pennsylvania jurisdictional basis), which equals the anticipated cost savings developed by company witness Kauffman ($336,000) plus associated fringe benefits ($53,881) less the additional expense attributable to the higher than anticipated wage increase received by the employees at Beaver Valley Unit No. 1 ($64,000). Moreover, if an adjustment is made to the company's claim for steam power maintenance expense (Section 2, *infra*), Penn Power asserts that the wage expense disallowance must be further reduced by $37,000 ($35,520 on a jurisdictional basis) to eliminate the overlap identified by its witness Pazak.

The OCA submits that in recommending adoption of staff's adjustment, the ALJ failed to accurately reflect the employee cost cutting measures in place for Penn Power.

In deciding this issue, we must first comment on the rationale being employed by the company. After noting that the actual number of employees has continued to grow from March 31, 1981, to March 31, 1983 (1,678 to 1,872), the company asserts that there is no reason to believe that this trend will be reversed. The company has apparently "watered down" its burden of proof on this issue.

Penn Power's claimed labor expense included a projection for additional employees at future test-year-end. In establishing the reasonableness of its claim, it is incumbent upon the company to establish that it will reach its budgeted employee levels at future test-year-end. It is not enough to merely establish that an upward trend exists. This type of rationale ignores the

possibility that the future test-year level of employees is overstated. That is clearly the case here. In fact, the actual number of employees at September 30, 1983, was 1,858, or fourteen employees less than at the beginning of the future test year. Therefore, it is questionable that the actual number of employees on Penn Power's payroll continues to grow.

Turning to the issue of an appropriate adjustment, the company maintains that the adjustment should not exceed $312,846 on a Pennsylvania jurisdictional basis. As indicated previously, the company estimated a cost savings of $336,000 plus associated fringe benefits of $53,881, which equals a total savings of $389,881 or $374,285 on a jurisdictional basis. In comparison, staff's proposed adjustment of $386,164 is slightly higher. However, the company further deducted $64,000 for expenses attributable to the higher than anticipated wage increase received by the employees at Beaver Valley Unit No. 1.

We would first note that the understatement of one expense is not justification for overstating a separate claim. Each individual expense projection should be supported in the record and stand on its own merit without regard to the accurateness of other expense estimates. In contrast to the company's view, we do consider it important to "scrutinize" individual accounts. By tediously examining the component parts that make up the total level of an expense, we believe that a more representative expense level will be reached. Were we to merely engage in an exercise of comparing one claim against another for the purpose of balancing the final results, we would not be focusing on the reasonableness of the claim at issue. In any event, and as staff recognizes, its adjustment may offset the effect of this unanticipated wage increase.

Staff's adjustment was based on an actual employee level of 1,872 as of the beginning of the test year (March 31, 1983), as opposed to the September 30, 1983, level of 1,858 utilized by the company in its analysis. Accordingly, staff has accounted for fourteen more employees in its adjustment, which, we recognize, has not been quantified for comparison.

More importantly, however, we question the validity of the analysis presented by company witness Kauffman for quantifying the cost savings attributable to the lower level of employees hired. As established in the cross-examination of witness Kauffman by staff, there is no evidence in the record which would indicate what entry level wage these new employees would be paid to substantiate the $336,000 cost saving associated with these employees. Quite simply, the record evidence does not support the validity of the company's proposed adjustment, and further, does not act to support a rejection of staff's disallowance.

In conclusion, we agree with the ALJ that staff's recommended adjustment to the company's claimed labor expense properly reflects the company's overstatement of employee levels at future test-year-end. The employee level utilized by staff (1,872) is conservative when compared to the employee level at the midpoint of the future test year (1,858), thereby providing for a margin of error. We consider the OCA's adjustment, which employs the historic 1981-83 ratio of actual to budgeted employees, to be dated and unrepresentative of the company's employment prospects. We shall adopt the ALJ's recommendation and deny all exceptions filed thereto.

b. *Management Salary Increases at March 1, 1987*

Penn Power has budgeted future test-year labor costs to annualize the impact of the company's annual in-

crease for salaried employees anticipated on March 1, 1984. The company estimated that the percentage increase would equal that received during the historic test year; i.e., 8.09 per cent.

The OCA proposes that the management increase totaling $778,000 plus fringe benefits be denied. The OCA considers this annualization to be inappropriate since it is speculative and since it has no bearing on either the economy or recent wage patterns in its service territory. According to the OCA, Penn Power did not attempt to justify the management increase based upon comparable activity in other industries in its service territory, nor on salaries needed to be competitive in its area. Further, the OCA witness Eckhaus testified that the assumed 8.09 per cent increase is not known and measurable and substantially above recent wage increases and forecasts of inflation.

Staff recommends a reduction of $91,971 to the company's claim. Staff witness Jones recommended that the company's projected increase be limited to 7 per cent, consistent with recent commission rulings involving other electric utility management salary requests: Pennsylvania Pub. Utiljty Commission v Pennsylvania Power & Light Co. R-822169 (7.5 per cent requested, 7.5 per cent granted); Pennsylvania Pub. Utility Commission v Metropolitan Edison Co. R-822249 (6.5 per cent requested, 6.5 per cent granted); Pennsylvania Pub. Utility Commission v Pennsylvania Electric Co. R-822250 (6.4 per cent claimed, 5.1 per cent granted).

In view of the discretionary nature of management salary increases and the company's claims of prevailing adverse economic conditions in its service territory, staff considers a 7 per cent management salary increase to be reasonable.

After first acknowledging that the precise amount of the increase cannot be quantified, the company responds to the OCA's proposal by asserting that it is unreasonable to assume that no increase will be granted. The company also argues that projections of expenses are an inherent and integral part of the future test-year rate-making concept.

In its reply brief, the company states that its salary schedule is amongst the lowest, if not the lowest, of any electric utility in the commonwealth. Further, the company maintains that the commission has rejected similar attempts to reduce a utility's claimed wage costs on the basis of "current economic conditions" or the prevailing rate of inflation. Finally, the company asserts that its claim for the projected increase for salaried employees is conservative in comparison to the increase negotiated by its union personnel (9 per cent) and should, therefore, be approved.

In reaching a recommendation, the ALJ first stated that where wage increases are not set forth in a contract, or otherwise not guaranteed, the commission has been willing to adjust salary claims downward. The ALJ cited Pennsylvania Pub. Utility Commission v UGI Corp. R-832331, Jan. 27, 1984, for commission precedent reducing claims for wage and management employee increases where no contractual obligation existed to grant increases. The ALJ also disagreed with the company's reading of the commission's decision in Pennsylvania Pub. Utility Commission v Duquesne Light Co. (1983) 57 Pa PUC 1, 51 PUR4th 198. Again relying on the UGI case, the ALJ stated that the decision in Duquesne did not stand for the proposition that current economic conditions would not be considered in reviewing salary increase expense claims, but merely for

the proposition that poor economic conditions must be set forth on the record. Here, the ALJ concluded that poor economic conditions had been established. In recommending the adoption of the OCA's adjustment which disallows the entire claim, the ALJ further relied on the lack of a contractual obligation.

The company filed an exception to the ALJ's recommendation. Therein, the company asserts that it is unaware of any Pennsylvania utility which has recently failed to grant annual wage increases to its employees. The company submits that it must maintain a competitive salary structure to attract and retain a skilled and qualified workforce regardless of economic conditions. The company also considers the ALJ's reliance on the UGI case to be misplaced.[10]

For the reasons set forth by the ALJ, we shall adopt the ALJ's recommendation which is to disallow the entire claim. We agree in full measure with the ALJ's reading of our decision in UGI which clearly set forth our position that we would consider poor economic conditions in reviewing salary increase expense claims where such conditions were set forth on the record. We further agree with the ALJ that poor economic conditions have been set forth on the record currently before us. In particular, the ALJ noted the high unemployment, industrial closings, cutbacks and wage concessions (Sharon Steel employees—9 per cent). Moreover, we are equally persuaded that the company failed to carry its burden of establishing the reasonableness of

[10]As a final note, Penn Power through an affidavit, indicated the percentage increase actually granted. On March 15, 1984, staff filed a motion to strike the evidence for the reason that it was submitted after the close of record which occurred on December 20, 1983. We find merit with arguments presented by staff in support of its motion and shall, accordingly, grant the motion to strike.

its claim. It appears that the company merely assumed a 8.09 per cent salary increase based on the same percentage increase granted in the historic test year. We need supporting data which establishes the reasonableness of such an increase, especially where there is no contractual obligation. Accordingly, the company's exception is hereby denied.

2. *Steam Power Maintenance Expense (Accounts 510-514)*

For steam power generation maintenance, the company expended $8,195,855 in the historic test year ended March 31, 1983. For pro forma future test-year purposes, Penn Power has claimed expenses of $10,606,450 for the same accounts, which is a 29.4 per cent increase over the historic test-year figure.

Staff recommends that these maintenance expenses be adjusted downward by $655,000. In deriving this adjustment, staff utilized a three-year average of historical data for the years ended March 31, 1982, and 1983, as adjusted for inflation, and the future test year ended March 31, 1984. Staff asserts that its adjustment is representative of a normal level of operations and the three-year averaging methodology was recently supported by the commission in Pennsylvania Pub. Utility Commission v Metropolitan Edison Co. R-822249, Oct. 19, 1983.

Through its witness Eckhaus, the OCA proposes a reduction in the company's claim by $1,969,000. OCA witness Eckhaus selected the level of expense incurred during the historic test year as a "normalized" amount and applied a 4.48 per cent inflation factor to the figure.

In support of its adjustment, the OCA relies heavily on record evidence that the company's recent historical

experience for expenditures for steam power generation do not substantiate the increase. Further, the OCA argues that the record is devoid of any evidence of expenses of a normal, cyclical nature that would justify the increase.

The company has stated that the 29.4 per cent increase was due to additional outage time at the Mansfield plant, a major boiler outage at Sammis Unit No. 7, New Castle No. 4 maintenance repairs, and additional maintenance associated with the air quality control system at the Sammis plant. In support of its 29.4 per cent increase, Penn Power contends that the historic test-year figure was an aberration and clearly represented an abnormally low level of expense for these particular accounts. Once the historic test-year expense figure is eliminated from the analysis, the company submits that its budget estimate is reasonable. According to company witness Pazak, the future test-year claim represents an increase of only 16.3 per cent over the level of expense incurred during the twelve months ended March 31, 1981, or less than the rate of inflation experienced in the intervening three-year period.

The ALJ prefaced her recommendation by first noting that the purpose of a normalizing adjustment is to levelize abnormalities to arrive at a reasonable expense level which reflects actual experience as best as possible. After referencing OCA Exh LSE-2, WP-8, which indicates that on a five-year calendar basis (1978-80) the accounts reflected an expense of $8,215,000 and on a more recent three-year calendar basis (1980-82) the accounts averaged $9,010,000, the ALJ concluded that the data supported staff's normalization adjustment.

The ALJ reasoned that these maintenance expenses are not completely predictable. As a result, the ALJ de-

termined that a comprehensive review of past experience is more valid than a narrow one. Before recommending adoption of staff's normalization method and the resulting disallowance of $655,000, the ALJ concluded that the OCA's method of adjustment was inferior because it only focused on a restricted period of actual experience.

Both the company and the OCA excepted to the ALJ's recommendation. Penn Power argues that steam power maintenance expenses are predictable since an upward trend has been established on the record, whether measured on a test-year or calendar year basis. Furthermore, the company submits that the averaging process, which gives equal weight to an obviously abnormal figure, generates an artificially low result. Finally, the company considers it inappropriate to focus on a single set of accounts since the interrelationship between production plant maintenance activities is thereby ignored. As an example, the company references its claim for nuclear power maintenance expense (Accounts 528-532) which is 17 per cent *less* than the costs incurred during the historic test year. If the commission concludes that its claim for Accounts 510-514 is abnormally high, the company contends that its budgeted level of expense for Accounts 528-532 must be similarly recognized as being abnormally low and in need of upward adjustment.

The OCA criticizes the ALJ's adoption of staff's methodology for the reason that the use of prior years for adjustment purposes runs the risk of including abnormally high dollar maintenance expenditures for bringing major units on line.

For the comprehensive reasons set forth by the ALJ, we shall adopt the ALJ's recommendation which is to

adopt staff's normalizing adjustment and the resulting disallowance of $655,000. We consider it entirely appropriate to give equal weight to the historic test-year expense figure. Although the company contends that this figure represents an abnormally low level of expense for these particular accounts, this argument ignores the possibility that these costs are headed downward. Furthermore, we again fail to discern how a claim for an unrelated expense, which is projected at less than the costs incurred during the historic test year, provides a basis for approving an overstated expense claim.

With respect to the OCA's adjustment, we share the same concern as the ALJ since we are leery of the OCA's strict reliance on the historic test year. Although a possibility exists that the historic test year is representative of future costs to be incurred, the possibility exists that the historic test-year figure is not representative. In vew of the mixed signals that we are receiving from the data, we consider staff's averaging methodology to be the most conservative approach to reaching a normal level for this expense and, therefore, the most appropriate for use in this proceeding.

3. *Tower Painting Costs (Account 571)*

Staff, through it witness Kalbarczyk, proposes a downward adjustment of $345,600 (as allocated for Pennsylvania jurisdiction purposes) to Penn Power's claim of $400,000 for its planned tower circuit painting project for the future test year. As proposed by staff witness Kalbarczyk, the entire amount of the project should be amortized over a ten-year period (the project life of the project), due to the nonrecurring nature of this expense.

The company argues that staff witness Kalbarczyk mistakenly assumed that it would not incur any tower

painting expense during the next ten years. Company witness Pazak summarized what he considered to be the essential flaws in staff witness Kalbarczyk's analysis:

"Mr. Kalbarczyk's recommendation was apparently based on his belief that the company would not incur tower painting costs for another ten years. While it is unlikely that the specific project to which Mr. Kalbarczyk refers will be repeated for another ten years, that line represents only one of 39 tower circuits on the company's transmission system, each of which must be painted and sprayed on a cyclical basis. Moreover, within the past year the company initiated a program under which at least one tower circuit (and probably more) will be painted per year. As a result, the level of expense claimed by the company is not abnormal or nonrecurring, but rather represents a reasonable estimate of the costs which the company will experience annually on an ongoing basis."

Staff submits the company has failed to establish the firmness of its commitment toward this program. In its reply brief, staff attempts to support its position by making the following points:

1. This is the first large scale tower painting project of any kind undertaken by the company;

2. The next circuit to be painted could not be identified with particularity;

3. Budgetary constraints may impede the progress of this project as has been the case in line spraying and clearing projects;

4. The origin of the project at higher management levels was not fully made clear.

Staff also argued in its main brief that the company's cost for the first painting of its longest line, a 345-

kilovolt line, is not a representative estimate to use for future tower painting cost projections.

Although the ALJ agreed that the 345-kilovolt line in issue is atypical, she found that no other cost data had been presented which would have shed doubt on the cost of this line as a basis for projecting maintenance costs. The ALJ did not consider the company's new program of tower painting speculative. Furthermore, the ALJ found that the company had projected costs based on actual experience and, therefore, recommended rejection of staff's proposed adjustment.

In its exception, staff notes that the burden of proof on this expense issue was not upon staff. According to staff, it provided sufficient opposition by establishing that the claimed expense was not adequately supported in the record. Further, staff maintains that amortization recognizes the ongoing nature of such projects while taking into account the less than firm nature of Penn Power's commitment to the project by spreading the cost over the useful life.

The company responds by asserting that amortization is only appropriate where it is shown that the expense item is abnormal and/or nonrecurring, which is not the case here. We agree.

Although we do not consider the supporting data to be overwhelming, we do accept the company's demonstrated commitment to implement an annual tower painting program at the expense level claimed herein. In so doing, we recognize the burden undertaken (39 tower circuits) and the need for regular maintenance of utility facilities.

Staff's opposition to the claim is premised, for the most part, on the firmness of Penn Power's commit-

ment to this program. As support for its adjustment, staff has presented reasons for rejecting the claim which question the viability of such a program. We consider this opposition to be based on pure speculation, which provides an insufficient basis for adjusting Penn Power's claim.

For the reasons set forth by the ALJ, we shall adopt the ALJ's recommendation which is to accept the company's claim and reject staff's proposed adjustment. Therefore, we shall deny the exception filed by staff.

4. *Meter Expenses (Account 586)*

As an expense item Penn Power has claimed $39,000 primarily for installation of a new meter reading system. Staff witness Jones has proposed a reduction of $31,200 (or $31,082 as allocated for Pennsylvania jurisdictional purposes) to the company's claimed meter expenses for the future test year. The company has projected an increase of $143,230 associated with Account 586—meter expenses. This amount represents a 22.3 per cent increase over the level incurred for the historic test year. According to Penn Power witness Pazak, the bulk of this increase can be attributed to a new meter reading system currently being implemented.

Staff witness Jones' proposed adjustment rests on the amortization of $39,000 in start-up costs over a five-year period. Thus, $7,800 would be included in the future test year, and the remaining $31,200 (before jurisdictional allocation) would be amortized over the next four years. Based on his assertion that these start-up costs are nonrecurring in nature, staff witness Jones recommends amortization of those costs over five years in the absence of more specific data on the expected life of the system.

While the company does not disagree with the theory of the proposed adjustment, the company believes that the appropriate amortization period is two years, which approximates the time it will take to completely install the new CIS system. Accordingly, the company argues that any adjustment of Account 586 should not exceed $19,426 ($39,000 total cost ÷ 2 × 99.62 per cent).

The ALJ first took cognizance of company witness Pazak's uncertainty as to the number of functions of the new employees, the expected start-up date of the system, and the expected useful life of the system.

As a result, the ALJ opined that the estimated useful life of the new system is a more appropriate basis for amortizing this one-time expense. The ALJ recommended that staff's adjustment of $31,082 be adopted. No exceptions were filed to the ALJ's recommendations.

For the reasons set forth by the ALJ, we agree with the disposition recommended by the ALJ. Accordingly, we shall adopt staff's downward adjustment of $31,082 to the company's claim.

5. *Uncollectible Accounts Expenses*.

Penn Power has claimed $598,200 for uncollectible accounts expense (Account 904). The company has derived this figure by increasing the historic test-year uncollectible accounts expense of $398,000 by $200,280 for future test-year purposes.

The OCA submits that the increase should be denied in its entirety based on the company's failure to sustain its burden of proof on the claim. In support of this position, OCA witness Eckhaus argued the following:

"The company has increased the historic test-year uncollectible accounts expense of $398,000 by $200,280

to reflect what it calls poor economic conditions, industry shutdowns, continued winter moratorium on shutoffs, reduced collection staff during the summer period, and higher rates in effect for the entire period. Unfortunately, the company has failed to quantify any of these factors and has arbitrarily assigned various dollar amounts to each of the factors considered . . . Therefore, there is no justification or analysis to support the company's proposed adjustment."

According to the OCA, there was no evidence submitted by Penn Power with respect to the relative impact of each of the five reasons for the increase referred to above. Arguing further, the OCA submits that the company's uncollectible estimate was not based on projections of historical patterns or tied to the level of revenues budgeted for the future test year.

The OCA noted that the company attempted to justify the substantial increase through the proof that the company is presently owed approximately $123,000 by four former industrial customers who have declared bankruptcy. With respect to this offer of proof, the OCA contends that the amount of uncollectibles associated with the four industrial customers may not be incremental to prior levels at all. In fact, the OCA maintains that the historical test-year uncollectible accounts expense had been less than it had been for the past several years.

Staff recommended an adjustment which was derived through the development of a write-off rate, representing the total write-offs (residential and commercial) to total revenue from the same classes for years ended March 31, 1981, to March 31, 1983. After applying that write-off rate to total adjusted residential and commer-

cial revenues for the future test-year plus the addition of a normalized level of uncollectibles attributable to industrial revenues, staff has calculated an allowance of $456,165 which equates to a reduction of $141,115 from the company's claim.[11]

Due to the difficulty in quantifying the relationship between poor economic conditions and high levels of uncollectibles, staff considers its methodology from an accounting standpoint. Furthermore, staff argues the effects of the winter shut-off moratorium are predictable from prior experience of the past five years and do not support the claimed 50 per cent increase over the historic test year.

Staff submits that its adjustment of $141,115 is appropriate in that it gives proper consideration to prior year's uncollectibles for all classes of customers. Finally, staff asserts that the evidence indicates that the claimed levels for industrial uncollectibles for the future test year were abnormally high when compared to the recent past, thus making normalization the proper accounting treatment.

The company is of the opinion that the adjustments prepared by staff witness Jones and OCA witness Eckhaus significantly understate the uncollectible expense which it will experience as a result of industrial customer write-offs. Penn Power emphasizes that it is presently owed $123,000 by four former industrial customers which it does not anticipate recovering. In light of existing bankruptcy laws, the company anticipates an increase in industrial terminations.

The ALJ concluded that staff has presented the best basis on which to project future test-year uncollectible

[11]No jurisdictional allocation was necessary.

expense. For the reasons set forth by staff in its main brief, the ALJ recommended adoption of staff's adjustment to reduce the company's uncollectible expense claim by $141,115. Although the company did not take exception to the ALJ's recommendation, the OCA did file an exception.

The OCA considers the ALJ's recommendation to be inconsistent with the evidence presented in this case. According to the OCA, despite finding the lack of any evidence of incremental industrial termination, the ALJ adopted staff's adjustment based upon an incremental increase in such terminations. Although the ALJ's discussion does appear confusing, we believe that the evidence in the record indicates poor economic conditions in the company's service territory which could positively impact industrial terminations. The OCA's argument is shortsighted and inconsistent with its position on the company's claim for management salary increases where the OCA emphasized the poor economic condition of Penn Power's service territory. Therefore, we are of the opinion that the $123,000 amount owed to the company by four former industrial customers should be given some weight in projecting future test-year uncollectible expense.

In furtherance of this objective we have reviewed the method proposed by staff which is to develop an appropriate write-off rate derived from data from prior periods, apply it to *total* expected revenues for the future test year, and normalize the abnormally high level of current industrial terminations. We consider staff's method for projecting a reasonable future test-year uncollectible expense to be the most appropriate for use in this proceeding. Therefore, we shall adopt the ALJ's recommendation which is to adopt the adjustment proposed by staff.

By using the methodology utilized by staff, we will account for the experienced write-off rate, employ current revenue projections for both residential and commercial customers, and moderate the abnormally high level of current industrial terminations through a normalization allowance. We find that these factors provide a comprehensive basis on which to project future test-year uncollectible expense.

6. *Rate Case Expense*

For pro forma purposes, the company has estimated total rate case expense of $314,773. Included within this total claim is $12,067 for the continued ten-year amortization of the company's rate case expense associated with its 1977 rate case at R-77110521 and the normalization of the estimated pro forma current rate case expense over a 12-month period amounting to $302,706.[12]

The OCA does not object to the continued amortization of the past rate case expense, but submits that the commission's practice of equally dividing present rate case expense between ratepayers and investors should be adhered to in this case. The OCA considers the 50–50 sharing practice to be an appropriate balancing of ratepayer and investor interests. Both the OCA and staff argue that the company's filing in this proceeding exemplifies the practices sought to be discouraged by the policy, as originally enunciated in Pennsylvania Pub. Utility Commission v Pennsylvania Power Co. (1982) 55 Pa PUC 552; i.e., repeated and excessive rate filings, a massive overbearing assault of legal and technical experts, operating inefficiencies, and relitigation of mat-

[12]Company witness Kauffman explained that the amount claimed for the 1977 rate case is based on the ten-year reamortization period adopted by the commission at R-811510.

ters consistently decided. The OCA states that the company has once again refused to reflect accrued debt interest and preferred stock dividends for cash working capital purposes, employed four outside consultants, and filed rate cases on a repeated basis. As a result of the annual amortization of the 1977 rate case expense and a 50–50 sharing of current rate case expense, the OCA recommends a disallowance of $142,501 to the company's overall rate case expense claim.

Staff recommends a disallowance of $185,000 in the company's rate case expense claim. Staff witness Jones proposes a 50–50 split or sharing of the current rate case expense between ratepayers and shareholders. According to staff witness Jones, the company has claimed an additional amount of $61,831 as an adjustment to expenses for the amortization of the 1977 rate case ($12,067), and for estimated expenses ($49,764), exclusive of payroll, over the budgeted test-year amount of $320,419. As detailed on Staff Exb LJ-1, this proposed 50–50 split of the company's claim ($320,419 and $49,764) would result in a normalization allowance of $197,000 ($12,067 and $270,183 ÷ 2) or a downward adjustment of the claim by $185,000. Staff shares the view of the OCA that sharing recognizes that both the utility and its investors, as well as ratepayers, benefit from a rate increase. Specifically, investors benefit from increased earnings on their investment while ratepayers are assured of continuing service from a more financially viable company, better able to attract capital. Furthermore, staff argues that the policy decisions supporting the sharing concept, which were set forth in Penn Power's last litigated rate case (R-811510), are fully applicable in this proceeding.

The company notes that this sharing practice which had once been commission policy, has since been aban-

doned.[13] The company also considers its claim to be conservative when compared to rate case expense estimates submitted by other Pennsylvania electric utilities. Finally, Penn Power contends that both the OCA's and staff's recommended adjustments have erroneously included $67,499 of allocated company payroll expense which would have been incurred regardless of any rate increase filing.

Staff counters by asserting that the $67,499 for payroll expense associated with rate case preparation is improperly included in the company's claim where the company's employees are fully compensated apart from any duties involving rate case work. If the company's entire claim is granted, staff contends that the company would be collecting twice for associated payroll expenses.

In the opinion of the ALJ, the 50–50 sharing of rate case expense is a just and reasonable policy. However, the ALJ recognized the recent commission decision in Pennsylvania Pub. Utility Commission v UGI Corp. R-832331, Jan. 27, 1984 and declined to apply a policy of sharing rate case expense on a 50–50 basis between ratepayers and shareholders.

With respect to specific adjustments, the ALJ found merit with staff's argument that the company failed to eliminate $67,499 from rate case expense, as no correlative downward adjustment had been made to Penn Power's wage and salary expense claim. In effect, the

[13]In support, the company has cited the following cases: Pennsylvania Pub. Utility Commission v Philadelphia Electric Co. (1983) 56 PUR4th 637; Pennsylvania Pub. Utility Commission v Equitable Gas Co. (1983) 57 Pa PUC 423, 54 PUR4th 406; Pennsylvania Pub. Utility Commission v Philadelphia Electric Co. (1983) 53 PUR4th 259; Pennsylvania Pub. Utility Commission v Pennsylvania Gas & Water Co. R-822102, April 25, 1983.

ALJ considered this to be a double counting of payroll expense for these employees. Finally, the ALJ acknowledged that no party challenged Penn Power's amortization of its 1977 rate case or its one-year normalization of current rate case expense. The ALJ recommended adoption of the company's claim except for a downward adjustment of $67,499. The OCA and Penn Power have excepted to the ALJ's recommendation.

As an initial response, the company asserts that it is procedurally improper for staff to propose an alternative adjustment in its reply brief. In any event, the company maintains that staff's "double counting" argument is in error.

By way of explanation, the company states that it has claimed $302,706 which represents the estimated cost of this proceeding. However, the company contends, as noted in its response to trial staff Data Request RE-15, that no company payroll is included in the $302,706 figure. According to the company, the $67,499 figure represents budgeted payroll costs which are included in the "test-year estimate" column of p. J1 of Penn Power Exh 1 (Future) as administrative and general expense and which, for accounting purposes, are booked to Account 928 (regulatory commission expense).

The OCA argues, in support of its exception, that an equal sharing of rate case expense is consistent with the commission's decision in Penn Power's last fully litigated rate case at R-811510.

We agree with the ALJ's recommendation to the extent that the ALJ has declined to apply a policy of sharing rate case expense on a 50-50 basis between ratepayers and shareholders. This is consistent with our

recent decisions. Pennsylvania Pub. Utility Commission v UGI Corp. R-832331, Jan. 27, 1984; Pennsylvania Pub. Utility Commission v Peoples Nat. Gas Co. R-832315, Jan. 13, 1983; Pennsylvania Pub. Utility Commission v Equitable Gas Co. (1983) 57 Pa PUC 423, 54 PUR4th 406. Furthermore, when tested against the standard of being a reasonable expense for rate-making purposes, we conclude that the company has met its burden of proof. There is no evidence of record which would indicate that the claim for current rate case expense is excessive.

However, we shall reject the ALJ's recommendation with respect to disallowing $67,499 of the company's current rate case expense claim. As indicated previously, and explained by the company in its exceptions, no company payroll costs have been included in the $302,706 claim for current rate case expense.

Based on the foregoing, we shall grant the exception filed by Penn Power and deny the exception filed by the OCA.

7. *Depreciation Expense*

As discussed under the depreciation reserve section of this opinion and order, trial staff has recommended a reduction of $253,068 to the company's claimed depreciation expense in order to reflect use of the remaining life depreciation methodology. We concur with the trial staff's recommended depreciation expense adjustment as previously discussed and, accordingly, will reduce depreciation expense by $241,680.[15]

[14]As noted by the company in its main brief, the claim for current rate case expense is within the expense range incurred by Penn Power in prior rate proceedings.

[15]See, pp. 602-605, *supra*.

8. *Canceled Nuclear Unit Costs*

In January, 1980, the CAPCO companies announced the cancellation of four nuclear generating stations then under construction, Davis-Besse Units Nos. 2 and 3 at Port Clinton, Ohio, and Erie Units Nos. 1 and 2 at Berlin Heights, Ohio. As explained by Mr. Pazak, the decision to terminate construction was based on a number of considerations, including growing political and regulatory uncertainties arising from the Three Mile Island incident, serious financial constraints of various CAPCO members, and a reduced need for additional future generating capacity.

In prior rate proceedings, consideration of the company's claim for the recovery of the expenses incurred with respect to these four units was deferred pending the outcome of the commission's extensive investigation of the CAPCO construction program at Docket Nos. 1-79070315 and I-79070317. See, e.g., Pennsylvania Pub. Utility Commission v Pennsylvania Power Co. (1982) 55 Pa PUC 552. However, on January 13, 1983, the commission entered its final order in that proceeding and expressly authorized Duquesne Light Company and Penn Power to amortize their respective shares of the cancellation costs in the appropriate rate cases over a period of ten years. Shortly thereafter, the commission allowed Duquesne to begin to recover these costs from its ratepayers. See Pennsylvania Pub. Utility Commission v Duquesne Light Co. (1983) 57 Pa PUC 1, 51 PUR4th 198.

Consistent with those determinations, the company has proposed that its investment, net of taxes, of $9,569,665 be amortized over a ten-year period, which equates to an annual amortization allowance of

$956,967. Mr. Pazak testified that the company's claim in this case is indistinguishable from that reviewed and approved by the commission in the recent Duquesne rate proceeding; i.e., it is based on a similar ten-year amortization period with no return having been requested on the unamortized balance of these costs. As in the Duquesne case, the dollar amount of the company's requested allowance has not been contested.

The OCA urges that the company's proposed amortization should be denied under the provisions of § 1315 of the Public Utility Code, 66 Pa.C.S. § 1315. OCA has presented legal argument similar to that argued in previous cases. As discussed under the land held for future use section of this opinion and order, this commission does not agree with the legal conclusion of the OCA on this issue. Our interpretation is set forth in Pennsylvania Pub. Utility Commission v Duquesne Light Co. (1983) 57 Pa PUC 1, 51-PUR4th 198, wherein we stated:

"In our view the quoted portion of the act is not entirely clear and to our knowledge there is no treatment as an alternative to inclusion in rate base, which this disjunctive phrase is designed to prevent. Consequently, to our reading the quote (sic) disjunctive prohibition is merely designed to prohibit both the inclusion of construction work in progress in rate base and any alternative rate-making action, which some inventive mind might create, as an alternative which would accomplish the same or similar result."

The OCA has not convinced us that our interpretation of § 1315 is incorrect; therefore, we will grant Penn Power an annual amortization allowance of $956,967.

9. *Tax Expense*

a. *Interest Deduction/Interest Synchronization*

The company has proposed a change in the calculation of interest expense for use in deriving the revenue

requirement for rate-making purposes in this case and in future cases. Staff opposes this change through the testimony of witness Robert F. Wilson. OCA has supported staff's position in its main brief.

Penn Power's proposed change and the method proposed to accomplish it are most clearly set forth in Mr. McDaniel's testimony who described the change as follows:

". . . This change relates to the calculation of interest expense which is employed as a reduction of pretax expense. In prior cases, Penn Power had followed the practice of applying the weighted debt component derived from its rate of return study to the net original cost rate base in order to arrive at the proper amount of interest expense for the determination of income taxes. Since the last case at R-821918 [which was in the main concluded by settlement], it has come to our attention that Penn Power's prior practice was in error and not in conformity with current IRS regulations. IRS Regulation § 1.46-6 [adopted in 1979] places certain limitation on the availability of investment tax credit depending upon the rate-making treatment afforded investment tax credit. Penn Power made a timely election under § 46(f)(2) of the IRC and, therefore, deferred investment tax credits may not be deducted from rate base. However, the amortization of previously deferred investment tax credits are fed back to operating income as a reduction of above-the-line income tax expense. In this regard, the company's rate-making treatment has been consistent with the requirements of § 46(f)(2). However, in determining the weighted cost of debt capital, the company's rate of return studies have only considered debt, preferred stock, and common equity as components without regard to investment tax credit.

For rate-making purposes, this practice results in an indirect reduction of income tax expense and, therefore, cost of service because interest expense has been calculated by application of the weighted cost of debt (debt component) to the net original cost rate base, without adjustment. IRS Regulation § 1.46-6(b)(4)(ii) deals with indirect reductions to cost of service or rate base and states in part, 'One type of such an indirect reduction is any rate-making decision in which the credit is treated as operating income (subject to rate making regulation) or as provided by anyone other than the common shareholders.' Penn Power's prior practice has resulted in such an indirect reduction of cost of service."

Trial staff witness Wilson testified that the company's proposed change is erroneous and that the interest expense should be calculated by multiplying the measure of value adopted by the commission by the weighted cost of debt adopted by the commission in its final order. He testified:

"The use of the weighted cost of debt allowed in the rate case and the measure of value allowed, result in the proper interest expense for rate case tax calculation purposes. This methodology has long been accepted by the commission and has been upheld by the courts, because it allows rate case taxes to be consistent with other findings in the rate case.

"The methodology I am recommending also has the effect of allowing higher actual returns on equity than those appearing in commission orders. It also allows a return higher than the overall cost of capital on the combined equity investment plus investment tax credit."

Mr. McDaniels argues that the commission's traditional derivation of interest expense for tax purposes for rate making treats JDIC as capital contributed by all classes of investors, including creditors, and that this results in treating JDIC not as if contributed by equity holders in contravention of IRS regulations, thereby raising the spectre of the loss of JDIC.

Mr. Wilson asserts that JDIC is actually capital contributed at zero cost, and that therefore the commission's traditional interest synchronization approach actually produces a higher rate of return on JDIC than on equity capital and that therefore no indirect effect occurs in contravention of the IRS regulations. He therefore concludes that no JDIC will be lost if the commission continues its traditional method.

Both trial staff and the OCA argue that the only authority which the commission should consider is a formal ruling by the Internal Revenue Service which could support the company's position. Such a ruling has not been issued.

The ALJ concurred with trial staff's analysis that the commission's present approach does in fact comply with all relevent IRS regulations by allowing a rate of return higher than the overall cost of capital. The ALJ also noted that although the regulation at issue here has been on the books since 1979, no Pennsylvania utility has been threatened with the loss of JDIC because of the commission's practice.

Congressional intent as discussed in the preamble to revisions to the Internal Revenue Code § 46, was to reduce the cost to a company of purchasing an asset, not to reduce the effective tax rate of the company over the life of the ass The lower effective tax rate results

from the ratable amortization being deducted from the cost of service.

The commission's methodology provides for the ratable amortization of the investment tax credit over the life of the property which gave rise to the credit. This yearly amortization is used as a credit to reduce the tax expense claimed in a rate case. This reduction to the current federal income tax claim results in a cost-of-service deduction, in the amount of the yearly amortization, calculated using the property's useful life for rate case purposes. The interest expense deduction thus is consistent with the other elements of the case, such as weighted cost of debt used in determining the allowed rate of return and the allowed measure of value.

The gravamen of Penn Power's claim is that the commission methodology is violative of the IRS regulations because it indirectly reduces the company's cost of service by treating eligible property as if financed by common equity. The company bases this assertion on its interpretation of §§ 1.46-6(b)(3)(ii) and 1.46-6(b)(4)(ii), which require that the credit be treated as if it were contributed by common shareholders and that it be allowed to earn a return not less than the overall cost of capital.

We agree with trial staff that this assertion is simply incorrect because it simplistically focuses only on the phrase "as if contributed by common shareholders" and completely ignores the other requirement. In fact, the commission methodology both treats the credit as if it had been contributed by common shareholders *and* the return actually allowed causes no direct or indirect effects upon the investment tax credit which would cause the company to be given a return on the credit less than the overall return allowed.

The commission's methodology also satisfies other relevant federal regulations. Specifically § 1.46-(a)(3) indicates that the credit will be lost to a utility taxpayer if rate base or cost of service is reduced by the credit faster than ratably; i.e., faster than over the life of the property. The method calculating interest expense used by the commission does not cause a greater than ratable reduction of cost of service or rate base.

Although not controlling under the specific matter at issue, we note that our practice of using the allowed weighted debt cost and measure of value to calculate the interest expense has been upheld in several recent appellate court decisions. See: Big Run Teleph. Co. v Pennsylvania Pub. Utility Commission (1982) 68 Cmwlth 296, 449 A2d 86; Carnegie Nat. Gas Co. v Pennsylvania Pub. Utility Commission (1981) 61 Pa Cmwlth 436, 433 A2d 938; and T. W. Phillips Gas Co. v Pennsylvania Pub. Utility Commission (1980) 50 Pa Cmwlth 217, 412 A2d 1118.

In accordance with the foregoing discussion, we conclude that the company had not persuaded us that our treatment of JDIC is violative of IRS regulations. Nor do we agree with the company that our treatment of JDIC will result in the loss of the investment credit.

b. *Normalization of Deferred State Income Taxes*

Penn Power has proposed to normalize its deferred state income taxes.

The OCA contends that the allowance of Penn Power's claim for the normalization of state income tax benefits resulting from accelerated depreciation would represent an unlawful burden placed upon Penn Power's customers in violation of the actual and reasonable tax

doctrine. The overall effect of the OCA's proposal, as stated by OCA witness Eckhaus, would reduced deferred tax expense on the income statement and measures of value by $1.123 million.

The OCA made no separate analysis of this issue in this proceeding, and conceded that it proposed the adjustment essentially for the purpose of preserving the issue which is presently on appeal by the OCA to the Pennsylvania supreme court.

As we stated in Pennsylvania Pub. Utility Commission v Philadelphia Electric Co. (1983) 56 PUR4th 637, 678:

"The company . . . notes the many benefits which the company and its ratepayers obtain as a result of employing normalization accounting. Firstly, normalization provides the true pattern of the company's expense, by recognizing the tax deduction in the same period as the underlying expense. Secondly, normalization increases the current cash flow, which improves the quality of earnings and interest coverage ratios. This, in turn, produces a reduction in the cost of attracting capital and in the amount of capital which must be attracted. Finally, normalization, from a regulatory standpoint, promotes rate stability through levelized tax deductions for rate-making purposes.

The OCA has presented no new or convincing argument which would lead us to change our reasoning fcr approving the normalization of deferred state income taxes. Normalization of taxes was unanimously affirmed by the commonwealth court in Cohen v Pennsylvania Pub. Utility Commission (1983)—Pa Cmwlth —, 463 A2d 1274. The OCA's proposed adjustment is therefore denied.

VII. *Rate Structure and Allocation of Increase*

Public utility rates must enable the utility to recover its cost of providing service and must spread this cost among the utility's customers in a just, reasonably, and nondiscriminatory manner.

Generally, there are two basic determinations to be made in a rate case: (1) how much of an increase is required by the utility and (2) how the increase should be allocated among the different customer classes.

In his "*Principles of Public Utility Rates*" (p. 291) (1961) James C. Bonbright discusses the "criteria of a sound rate structure." The eight items listed by Bonbright are:

"1. The related, 'practical' attributes of simplicity, understandability, and feasibility of allocation.

"2. Freedom from controversies as to proper interpretation.

"3. Effectiveness in yielding total revenue requirements under the fair return standard.

"4. Revenue stability from year to year.

"5. Stability of the rates themselves, with a minimum of unexpected changes seriously adverse to existing customers.

"6. Fairness of the specific rates in the apportionment of total costs of service among the different customers.

"7. Avoidance of 'undue discrimination' in rate relationships.

"8. Efficiency of the rate classes and rate blocks in discouraging wasteful use of service while promoting all justified types and amounts of use:

"(a) In the control of the total amounts of service supplied by the company.

"(b) In the control of the relative uses of alternative types of service."

The ALJ provided a succinct discussion of the various cost-of-service studies and rate design positions of the parties. We shall refer extensively to the ALJ's discussion.

A. *Cost of Service*

In its main brief, the company explained the purpose of a cost-of-service study, which provides as follows:

"The purpose of any cost-of-service study is to allocate plant and expenses among the various classes of service in a manner which reflects each class' relative contribution to the incurrence of those costs. As explained by Mr. Harris, such an analysis typically consists of three basic steps—functionalization, classification and allocation. Costs are first functionalized based upon the function for which they are incurred; i.e., production, transmission, distribution, etc. Each function and/or subfunction is then classified as customer related, demand related, energy related, or some combination of the three. Customer-related costs are those which vary in accordance with the number of customers on the system; demand-related costs vary with the level of kilowatt demand; and energy-related costs vary with the level of kilowat-hour usage. Once costs are so classified, they are allocated to the various customer classes

based on the number of customers, demand, or energy usage of the particular class."

The company has presented a cost-of-service study prepared by Mr. Gerald Harris. The OCA submits that there are three main errors incorporated in the company's study.

1. *Allocation of Power Supply Costs on the Basis of the Company's Average and Excess Methodology.*

The OCA asserts that the allocation of excess power supply costs on the basis of class maximum diversified demand or class noncoincident peaks minus average demand, does not accurately reflect cost-causative class demands. According to OCA, the company allocation is wrong because it is irrelevant to measure class imposed power supply costs. OCA witness Ruback states:

"The sum of each class' noncoincident peak demand has a tenuous relationship with the cost-causative factors which influence the power supply function."

Therefore, OCA witness Ruback has performed and submitted on this record an independent cost-of-service study.

The OCA in its cost-of-service study allocates the excess demand on the basis of customer class contributions to the 12 monthly peaks less average demand. It is the contention of the OCA that the "12 monthly peaks" method more accurately assigns to each class its respective share of costs imposed on the company's system during a year. The OCA notes that the company employed the "12-month coincident peak" method in its most recent FERC allocated cost-of-service study. Further, OCA witness Ruback contends that the "12-

month coincident peak" method considers that production facilities are installed to meet demand from month to month and that monthly peaks have an impact on total capacity since they determine the extent to which generating equipment may be taken out of service for maintenance and repair.

The OCA contends its power supply allocators (12 monthly peaks) more accurately assign to each class its cost-causative share imposed on the company's system over the year.

A comparison of cost-of-service study power allocators between the OCA and the company follows:

Rate Schedule	*OCA*	*Company*
Residential	0.2074	0.2704
WH	0.0260	0.0099
Subtotal	0.2334	0.2803
GS	0.1079	0.0791
GM	0.0873	0.0942
GL	0.5285	0.5051
SL	0.0033	0.0036
Total Ret	0.9604	0.9622
MRS	0.0396	0.0378
Total	1.0000	1.0000

The company contends that the OCA method improperly assigns less costs to the residential customer class and greater costs to the commercial and industrial customer classes. Further, rather than sharing the benefits of diversity to classes, the OCA method assigns benefits to those customer classes whose loads happen to be low at the occurrence of the twelve monthly peak hours in question. It is the position of the company that the "12-month coincident peak" method can and will produce unstable results. Independent of theoretical problems, the company asserts that the OCA allocation factors were developed using data from three separate

and discrete time periods, therefore the factors have no relationship to cost experienced in the historic and future test years, or any other period and have no probative value.

Sharon argues that the OCA's study is designed to shift allocations away from the residential class, and is thus unfair and arbitrary and should be rejected.

Staff did not object to the general usage of the company's cost-of-service study, but indicated that if its own recommended rate design is adopted, new class characteristics may be experienced which will change the primary and secondary customer cost-of-service allocation.

The parties also pointed that the OCA espoused a different method in the last case.

The ALJ recommended acceptance of the company's position because it appeared to be more reflective of cost-causative factors than that proposed by the OCA. According to the ALJ, the company's method has been approved by this commission in previous rate proceedings and is consistent with standards set forth in the NARUC electric utility cost allocation manual. Finally, the ALJ stated that the OCA's factors were developed from three separate discrete time frames which indicates a questionable relationship between the factors and costs experienced or projected.

The OCA filed an exception to the ALJ's recommendation. The OCA argues again that its "12-month coincident peak" method more accurately reflects cost-causative class demands since it is based on class contribution to system peak demands over the course of the whole year. In addition, should the commission have doubts about the data employed in this case, the OCA

contends that the commission should require Penn Power to utilize the "12-month coincident peak" approach in its next case.

2. *Allocation of Distribution System Investment Between Primary and Secondary Functions*

The OCA submits that the company's 60-40 allocation between primary and secondary functions of investment and associated costs is unsupported. Based on the company's allocation factors proposal, the OCA asserts that as the secondary service share of distribution costs increase, customer classes receiving service at secondary voltage experience disproportionately increased costs. A major difficulty, in the opinion of the OCA, is that the 60-40 allocation is based upon a study performed by the company a number of years ago and subsequently lost. A confirming analysis premised upon a review of distribution poles and assigned usage, either secondary or primary, was performed by the company. The OCA alleges that the company's study includes double counting of certain poles and if the double accounting is eliminated, the allocation study would indicate a pole split of 64-36 primary to secondary. Further, the OCA maintains that another problem deals with the allocation of all poles over 30 feet tall, 19 per cent of which have been allocated to secondary use. According to the OCA, the 19 per cent allocation is merely an approximation and is unsupported by any studies.

Although the distribution pole analysis was presented as a proxy for the company's lost study and does approximate the 60-40 split, the OCA contends that this commission should expect a higher level of analysis than the company presented in this proceeding.

The company asserts that, even though the OCA analysis indicates that 64 per cent of the costs are assign-

able to primary service, the OCA's only justification for its 70 per cent recommendation was its contention that the company would devote 19 per cent of its 50-foot distribution poles to secondary service. The OCA witness, the company contends, admitted that he did not know under what circumstances the company would install a 50-foot pole.

The ALJ found merit with the OCA's criticism of the company's 60-40 allocation factor supporting data and studies. According to the ALJ, the company's distribution allocation, premised on a lost study, is unacceptable and unprofessional. However, the ALJ found that the OCA's analysis supports only a 64-36 allocation, not the 70-30 it recommends. The ALJ concluded that the company has clearly failed to meet its burden of proof here.

Therefore, the ALJ recommended the acceptance of a 64-36 primary-secondary allocation based on the OCA's analysis and also recommended that the commission order the company to perform a study in this area for its next rate filing.

3. *Employment of the Modified Zero Intercept Method to Develop the Customer Component of the Distribution System*

Although critical of the modified zero intercept methodology of the company, the OCA alleges that, even if the theory is accepted, the company's method for calculating the minimum distribution grid system is unrelated to the company's distribution system. The zero intercept method assumes a degree of demand component in even the smallest unit of the distribution system. The modified zero intercept method as employed by the company employs embedded labor costs

booked in plant accounts as a surrogate for the zero intercept method results.

OCA witness Ruback indicates that the modified zero intercept method contains two basic weaknesses. The first is that the use of the Handy-Whitman Index, which is regionalized and therefore does not provide an accurate index for a rural service area such as served by Penn Power, produces skewed results. Secondly, the OCA points out that the company did not perform any confirming analyses, but relied solely on the Handy-Whitman Index. The OCA contends that if rate base questions require confirming analysis then rate structure questions require equal confirming analysis.

Furthermore, it is the OCA's contention that there is no identifiable customer-related cost component in a distribution system other than services and meters. According to the OCA, distribution systems are not designed for zero load, but to meet the demands of the area served by the distribution plant. Assigning a customer component to a distribution system is not, in the OCA's opinion, assigning costs to the cost-causative factor. However, the OCA submits that it is reasonable and appropriate to assign a customer component to costs which vary with the number of customers.

With respect to the OCA's position that all distribution costs, other than those associated with meters and services, should be allocated on the basis if demand, and company states that this position has been rejected by this commission in the company's last fully litigated rate proceeding at R-811510, and also at Pennsylvania Pub. Utility Commission v Duquesne Light Co. R-811470; Pennsylvania Pub. Utility Commission v Metropolitan Edison Co. R-822249; and Pennsylvania

Pub. Utility Commission v Pennsylvania Electric Co. R-822250.

Sharon Steel supports the company's cost-of-service study methodology and urges that the company's study be used as a guide for setting rates in this case. However, Sharon's support is qualified because of the manner in which the company's data was used in the preparation of the study. According to Sharon, the study was not presented in terms of actual customer rate classifications, but in an arbitrary grouping apparently used solely for preparing and presenting the results.

Based on past commission practice, the ALJ recommended rejection of the OCA's position and adoption of the company's position. The OCA filed an exception to the ALJ's recommendation.

In support, the OCA argues that regardless of the commission's practice of adopting the use of a minimum distribution grid to develop customer-related costs, the approach put forth by the company has no substantial relationship to its particular service territory. In addition, the OCA submits that there is no relationship per se between the number of customers and the cost of the distribution system. According to the OCA, the cost of Penn Power's system is more a function of geography than the number of customers.

4. *Exceptions of Sharon Steel Corporation*

After analyzing the company's cost-of-service study, Sharon Steel has taken the position that the study grossly understates the rate of return produced by Sharon Steel. These alleged overstatements of costs are set forth below.

a. *ECR Revenues and Expenses*

According to Sharon Steel, the ECR collects revenues on a uniform, average basis while the expenses are in-

curred on a nonuniform basis, chiefly because of line losses related to the service level. As a result, Sharon Steel argues that a mismatch occurs which operates to understate the return provided by the high voltage level customers, such as Sharon Steel, on a total cost-of-service basis.

b. *Voltage Level*

Sharon Steel submits that the higher the voltage level, the lower the cost of service because of lower line losses and lower equipment needs. Therefore, Sharon Steel maintains that Penn Power's combining of the 138-kilovolt and 69-kilovolt customers for cost-of-service purposes operates to overstate the cost and thus understate the return from the 138-kilovolt customers including Sharon.

c. *Power Factor*

Sharon Steel contends that it is more efficient to serve a customer with a higher power factor. According to Sharon Steel, the cost revenue curves prepared by Penn Power to show the effect of its rates were based upon a 90 per cent power factor in contrast to its actual power factor of 99 per cent. Therefore, Sharon Steel asserts that Penn Power's study does not reflect the effect of a leading power factor which supplies reactive power to the system and operates to understate the return of high power factor customers, such as Sharon.

d. *Average Energy Costs*

Sharon Steel states that there is a cost differential in Penn Power's energy cost depending upon whether the energy is supplied at on-peak or off-peak times. Sharon Steel submits that this cost differential is not reflected in the company's cost-of-service study and results in an

overstatement of the cost of serving customers who use a majority of their power off-peak; such as Sharon.

5. *Conclusion*

[18] In Pennsylvania Pub. Utility Commission v Duquesne Light Co. (1983) 57 Pa PUC 1, 51 PUR4th 198, we put the issue of a utility's cost-of-service study in perspective (57 Pa PUC at p. 61, 51 PUR4th at p. 252):

". . . [a] cost-of-service study is one of the most subjective elements in any rate case. The methods used for classifying items of plant and expense between demand, customer, and energy components are far from being an exact science. Cost-of-service studies are more accurately characterized as engineering art. (Emphasis deleted.)

"This commission has historically recognized the cost-of-service study for what it is: a useful tool for testing the reasonableness of the proposed allocation of the revenue requirement. Rarely, if ever, is the revenue requirement allocated strictly on the basis of cost-of-service results. In most instances, and this case is no exception, the revenue allocation is based primarily on other factors such as economic impact and rate continuity with some modification due to cost-of-service considerations."

Our position is still the same as we continue to view a cost-of-service study as merely a useful tool for testing the reasonableness of the proposed allocation of the revenue requirement. See also, Pennsylvania Pub. Utility Commission v Metropolitan Edison Co. R-822249, Oct. 19, 1983; Pennsylvania Pub. Utility Commission v UGI Corp. R-832331, Jan. 27, 1984.

Therefore, the main issue before us is whether or not the company's cost-of-service study is acceptable, tak-

ing into consideration the limited purpose that we shall use it for; that is, as a guide to the reasonableness of the revenue allocation. Based upon the evidence presented here, we conclude that the company's cost-of-service study is acceptable for this limited purpose. The exceptions of the OCA and Sharon Steel are, accordingly, denied.

B. *Rate Design*

1. *Restructuring of Rate Classification*

For use in this proceeding, Penn Power proposes a restructuring of its present customer rate classifications. Specifically, the company proposes the consolidation of existing commercial classes GS, GM, and GL and industrial classes LP and LT into three rate classifications based on level of *demand*. This change, according to company witness Pazak, aligns secondary, primary, and transmission customers experiencing similar load and energy characteristics and eliminates distortions resulting from migration of large transmission voltage customers to primary or secondary designed rates. Inclusion within each class will be determined by the customer's *demand*. Rate GS, for customers with load below 50 kilovolt-amperes, will comprise the largest class in terms of number of customers. Rate GM will be available for customers between 50 and 200 kilovolt-amperes. Rate GL, for customers above 200 kilovolt-amperes, will be the largest class in terms of sales. Staff submits that this proposal should be rejected because it is flawed in several respects and results in an inappropriate revenue allocation.

The crux of staff's recommendation, developed by staff witness Rosenthal, is that the general service rate classes should be aligned by *voltage* level, rather than by *demand*. Thus, staff would combine the three transmission voltages (23 kilovolts, 69 kilovolts, and 138 kilovolts) into one class, the three primary voltages into another class, and have a third class for secondary customers. In particular, staff witness Rosenthal's proposal would provide the following:

(1) Combine the transmission customers on Penn Power's current Rates LT (forty-five customers) and GL (three customers) into new Rate TP (transmission power);

(2) combine the primary customers on company Rates L (sixty-six customers), GM and GL (eighty customers) into new Rate GP (general—primary); and

(3) combine the 13,450 secondary customers now on Rates GS, GM, and GL into new Rates GS (general service).

According to staff, the use of voltage level as a rate class determinant accurately aligns available rate schedules with costs incurred in providing service and costs invested by the customer in taking power. Secondly, staff contends that the company's present and proposed end-use premised rate design suffers from the migration of customers in certain instances. Thirdly, staff contends that its rate design will be easier and less expensive to implement than the company's proposal which for Rate GM would require a change to kilovolt-ampere metering.

After reviewing the blocking and pricing scheme advanced by the company, staff witness Rosenthal made certain recommendations to produce rates which the witness submits will give a good incentive for efficient energy use as well as ensuring an orderly transition to his new rate schedules.

For general service secondary customers (Rate GS), staff witness Rosenthal proposed the following recommendations:

1. Retention of a minimum/customer charge which includes the first three kilowatts of billing demand;

2. A uniform capacity (demand) charge on all demand in excess of the first three kilowatts; and

3. Three energy blocks: first 150 hours use; next 100 hours use; and all use over 250 hours use.

According to staff, this system would provide an incentive for increasing hours use of demand and it would be more equitable to include the first three kilowatt-hours of demand in the minimum/customer charge than to have no minimum.

For primary service customers (Rate GP), staff witness Rosenthal recommends:

1. A uniform capacity charge on all kilovolt-amperes of billing demand; and

2. Energy charges split into three blocks: first 250 hours use; next 200 hours use; and all use over 450 hours.

Staff maintains that the only difference between this rate design and the company's is that the tail block (over 450 hours use) rate is available to all primary customers.

For Rate TP, staff witness Rosenthal, although accepting the company's proposed GL blocking, repriced blocks to assure that the customers at 23 kilovolts or with higher hour usage are providing a reasonable return. Additionally, staff would place a minimal increase

on demand above 80,000 kilovolt-amperes and propose an energy price below current levels for usage above 450 hours use.

Sharon Steel has taken the position that it should receive a rate decrease and that Rate GL should be redesigned to achieve that purpose.

According to Sharon Steel, the company's current and proposed rates do not track cost of service adequately and need to be changed.

The OCA has not taken a full position on this issue. However, to the extent Sharon Steel employs the company's cost of service, the OCA argues that Sharon's suggested rate of return may be overstated.

With respect to staff's proposals, the company first believes that the classification of customers by voltage level is not required. Secondly, the company argues that implementation of staff's recommended rate schedules would require the conversion of 96 Rate GL secondary customers from kilovolt-ampere to kilowatt metering, which would be contrary to the company's philosophy of encouraging its customers to improve their load factors and not be in the ratepayer's best interest. Thirdly, if staff's voltage level rate classifications were adopted, approximately 601 customers would no longer be subject to the 60 per cent ratchet clause which is presently applicable to Rates GM and GL, thereby increasing the risk of revenue instability. Finally, the company opposes staff's recommended design of Rate GS, as it is committed to eliminating the invested demand feature —i.e., no charge for the first three kilowatts of demand —of Rate GS, which under staff's proposal would be re-

tained and made applicable to an additional 601 customers.

The company argues that Sharon Steel's position should be rejected because it is based on average costs which Penn Power contends do not provide an accurate measure of the costs of serving Sharon. Equally, Penn Power asserts that Sharon Steel's recommended remedy could have a disruptive effect on the rate charged to other Rate GL customers.

In reply to Penn Power's statement concerning the conversion of 96 Rate GL—secondary customers from kilovolt-ampere to kilowatt metering, staff submits that such a switch will have no effect on improvement of load factor:

With respect to the company's contention as to the effect of staff's proposal on the demand ratchet, staff suggests an alternative at p. 4 of Staff Statement RAR-1, which would create a large secondary rate and could incorporate that feature. Staff is of the opinion that the ratchet should not be reimposed on the mass of secondary customers of the company. According to staff, the diversity of these customers is sufficient to permit these loads to be unratcheted.

The ALJ determined that Sharon Steel had not met its burden of proof on this issue since it had not adequately quantified and supported its claim. However, the ALJ found merit with Sharon Steel's contention that its analysis of the company's cost of service was adversely affected by the limited information available. After recommending rejection of Sharon's position, the ALJ recommended that the company be directed to furnish the information required by Sharon Steel in its next rate proceeding, in order that the commission may fully consider Sharon's position.

Sharon Steel excepted to the ALJ's recommendation and argued, for the most part, points previously made in brief. However, Sharon Steel additionally argued that it was erroneous for the ALJ to hold that the burden of proof was upon Sharon with respect to the proposed rates.

We agree, as the company argued, that Sharon Steel's calculation is based on average costs and does not provide an accurate measure of the costs to serve Sharon. As a result, we agree with the ALJ that the Sharon Steel has not quantified or supported its claim that the return which *will* be earned by Penn Power from Sharon's service is excessive. To this extent only, we agree with the ALJ's recommendation. Even though the ALJ stated that Sharon did not carry its burden of proof, we more correctly note that Sharon has not persuaded us that it has adequately quantified and supported its claim. Furthermore we shall direct the company to furnish the information required by Sharon. Accordingly, Sharon Steel's exception is denied.

The ALJ also recommended that staff's proposal be rejected. In the opinion of the ALJ, the company's proposal to restructure certain customer classifications based on demand is reasonable and adequately supported. According to the ALJ, the company must construct its system to meet demand and voltage levels are only a subordinate part of meeting demand. After recognizing that staff's proposal will eliminate some costs, the ALJ concluded that other major costs of voltage service and

of meeting demand will remain. While acknowledging that staff's proposal would recognize certain efficiencies of high voltage service, the ALJ reasoned that Penn Power's rates presently recognize these through high voltage discounts. In light of the company's interest in load management and meeting its load demands, the ALJ recommended that the company's proposal be adopted.

Staff has filed an exception to the ALJ's recommendation and first argues that its rate design, by necessity, reflects Penn Power's actual demand costs since its proposal was developed by using the cost data supplied by the company. Further, staff asserts that it has in fact recommended retention of the company's high voltage discounts. Nevertheless, staff submits that this discount cannot be considered a substitute for needed changes in the pricing of the rate blocks.

Finally, staff notes that the ALJ failed to address the problem of customer migration between rate schedules if staff's proposal is adopted. According to staff, the ALJ also failed to address its proposal that the first three kilowatts of billing demand be included in the customer charge for general service customers.

We find merit in staff's proposal that the general service rate classes should be aligned by voltage level, rather than by demand as advanced by the company. As explained by staff, the utilization of voltage level accurately aligns available rate schedules with the attendant costs involved, eliminates the problem of customer migration, and is easier and less expensive to implement.

Consistent with our adoption of staff's proposal to align general service rate classes by voltage level, we

shall adopt staff's rate design proposal for commercial and industrial customers. We agree with staff that this will provide the necessary incentive for efficient energy use. Finally, we will adopt staff's alternative at p. 4 of Staff Statement RAR-1 which will result in the creation of a large secondary rate and incorporate the demand ratchet.

Based on the foregoing, we shall grant staff's exception and adopt its proposals.

2. *Description of Company's Charges on the Bill*

The OCA recommends that the company, in addition to the information currently provided on customer bills, state the following information: customer charge and calculation of the kilowatt-hour charge or, on demand metered customers, the kilowatt-hour per kilowatt charge, both of which can change with level of usage.

The company proposes to notify its customers, on an annual basis of the current residential customer charges and energy charges and to provide a sample calculation of a typical residential bill through a separate bill insert.

The ALJ recommended acceptance of the company's proposal which the ALJ considered similar to an approach accepted in Pennsylvania Pub. Utility Commission v Philadelphia Electric Co. (1983) 56 PUR4th 637, 682, 683. No exceptions were filed to the ALJ's recommendation. Finding the company's proposal reasonable, we shall adopt the ALJ's recommendation.

3. *Late Payment Charges for Customers Taking Service Under Multiple Rate Schedules*

The company proposed an increase to 3 per cent in monthly late payment charge for its GS, GM, and GL

customer rates. Streetlighting service and residential customer classes are subject to a monthly late payment charge of 1.35 per cent.

Staff recommends that the commission should order consistent late payment charges for streetlighting and general service customers.

Sharon Steel contends that the 3 per cent late payment charge, totaling 36 per cent per year, is excessive and unwarranted. Secondly, it argues that the language of the late payment charge is such that the penalty for late payment is the same whether it is one or thirty days late.

The ALJ agreed that the company's proposal of a 3 per cent late payment charge was excessive and that there should be an incentive in the late payment charge to induce customers to make payment sooner than a full month late. Therefore, the ALJ recommended rejection of the company proposal. No exceptions were filed to the ALJ's recommendation.

Staff noted that the company has governmental and municipal customers which take service both under the general service rate as well as the streetlighting rate. To avoid future confusion, staff recommends that the streetlighting and small general service customers late payment charges be set at the same level.

We agree with the ALJ to the extent that the ALJ has found the company's 3 per cent late payment charge excessive. However, we also find staff's recommendation reasonable. Therefore, we shall adopt staff's recommendation and maintain streetlighting late payment charges at 1.35 per cent.

C. *Revenues Allocation*

Staff has proposed the following revenue increase allocation:

Classes	
Residential	*Increase*
	%
Residential	
RS	14.2
WH	3.9
Total	13.5
General Service	
Secondary	12.7
Primary	10.0
Transmission	13.6
Total	12.9
Streetlighting	
SV	2.9
SI	20.2
SM	12.5
Total	13.2
Total	13.1

As indicated above, staff has accepted the company's proposed revenue increase allocation (residential and streetlighting), except to the extent that some shift occurs under general service classes consistent with staff's rate schedule alignment and internal rate design. Consistent with our decision to adopt staff's proposal to align general service rate classes by voltage level and adopt staff's rate design proposal for commercial and industrial customers, we find staff's proposed revenue requirement allocation, in conjunction with the company's cost-of-service study, reasonable and acceptable, as appropriately scaled back to conform to our revenue requirement finding herein. Accordingly, we shall grant staff's exception to the ALJ's failure to adopt its rate design proposals, and, accordingly, adopt staff's proposed revenue allocation.

Since the OCA proposed revenue allocation is premised on its own cost-of-service study, which we have rejected, we shall similarly reject the OCA's increased revenue distribution which is premised upon that cost-of-service study.

VIII. *Conclusion*

In view of the foregoing, we find that Pennsylvania Power Company is entitled to an opportunity to earn income available for return of $48,298,000. This constitutes an increase in annual electric base rate operating revenue of approximately $15,364,000 (excluding state tax adjustment surcharge revenue and energy cost rate revenue), or approximately 77 per cent of the requested base rate increase of $19,890,200. In furtherance of such an objective, Pennsylvania Power Company is authorized to establish rates which will produce 184,186,000, in annual operating revenues, in such a manner more fully described in the ordering paragraphs [omitted herein].

APPENDIX F

Judgment of the Pennsylvania Supreme Court

SUPREME COURT OF PENNSYLVANIA
WESTERN DISTRICT

DAVID M. BARASCH, Consumer Advocate

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION

Appeal of: EQUITABLE LIFE ASSURANCE SOCIETY, JOSEPH HORNE COMPANY, KAUFMANN'S and GIMBELS

DAVID M. BARASCH Consumer Advocate, Appellant

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION

No. 33 W. D. Appeal Docket 1983

Appeal from Order of the Commonwealth Court dated June 13, 1985, at No. 553 C.D. 1983, affirming the decision of Pennsylvania Public Utility Commission entered January 28, 1983, at R-821945.

No. 34 W. D. Appeal Docket 1986

Appeal from Order of the Commonwealth Court dated June 13, 1985, at No. 1364 C.D. 1984, affirming the decision of Pennsylvania Public Utility Commission entered April 11, 1984, at R-832409
90 Pa. Cmwlth. 98, 494 A.2d 58 (1985)
ARGUED: March 11, 1987

JUDGMENT

ON CONSIDERATION WHEREOF, it is now here ordered and adjudged by this Court that the judgment of the COMMONWEALTH COURT OF PENNSYLVANIA be, and the same is, hereby REVERSED.

/s/ IRMA T. GARDNER

Irma T. Gardner
Deputy Prothonotary

DATED: October 15, 1987

APPENDIX G

Notice of Appeal

IN THE SUPREME COURT OF PENNSYLVANIA
WESTERN DISTRICT

DAVID M. BARASCH, CONSUMER ADVOCATE v. PENNSYLVANIA PUBLIC UTILITY COMMISSION, APPEAL OF: EQUITABLE LIFE ASSURANCE SOCIETY, JOSEPH HORNE COMPANY, KAUFMANN'S AND GIMBELS	No. 33 W.D. Appeal Docket 1986
DAVID M. BARASCH, CONSUMER ADVOCATE, APPELLANT v. PENNSYLVANIA PUBLIC UTILITY COMMISSION,	No. 34 W.D. Appeal Docket 1986 Consolidated Appeals

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that Pennsylvania Power Company and Duquesne Light Company, the intervenors in the above-captioned proceeding, hereby appeal to the Supreme Court of the United States from the final judgment of the Supreme Court of Pennsylvania, reversing the judgment of the Commonwealth Court of Pennsylvania, entered herein on October 15, 1987.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

Respectfully submitted,

/s/ ALAN L. REED

Alan L. Reed
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Attorney for Intervenor
Pennsylvania Power Company

[Filed: Jan. 7, 1987]

APPENDIX H

Excerpts from the CAPCO Investigation
(as printed in the reproduced record before the
Pennsylvania Supreme Court).

BEFORE THE

PENNSYLVANIA PUBLIC UTILITY COMMISSION

Investigation Upon the Commission's Motion into the Delays in the CAPCO Construction Schedule	I-79070315 I-79070317

REPORT OF INVESTIGATION

BEFORE: Joseph P. Matuschak
Administrative Law Judge

I. HISTORY OF THE PROCEEDING

On January 26, 1979, Duquesne Light Company (Duquesne or Company) filed with the Commission a Tariff Supplement to become effective March 27, 1979, proposing changes in rates, rules and regulations calculated to produce $106,614,868 in additional annual revenues, based on levels of business at September 30, 1978.

On February 23, 1979, the Commission ordered an investigation and suspended the proposed rates until October 27, 1979.

By its order of July 12, 1979, the Commission approved a revenue increase in the amount of $58,000,000 for electric service rendered on and after July 15, 1979, based on the adjusted test year ended September 30, 1978, as stipulated to by the major intervenors, in lieu of the $106,614,868 increase that had been proposed by the Company and suspended by the Commission.

At that time, however, simultaneous with the act of approving the rate increase, the Commission instituted an investigation focused on three complex substantive areas that demanded separate investigations, namely: (1) the impact of the extended outage at Beaver Valley Unit No. 1; (2) CAPCO construction delays; and (3) conservation incentives.

In November, 1978, CAPCO announced major delays in its construction schedules of seven large generating units, ranging from 16 to 36 months.[1]

[1]

Unit	Total Capacity	Old Schedule	New Schedule	Delay
Perry #1	1,205	1981	4/31/83	16 months
Beaver Valley #2	833/862	1982	5/1/84	24 months
Perry #2	1,205	1983	4/30/85	22 months
Davis-Besse #2	906	1985	4/1/88	36 months
Erie #1	1,266	1986	4/1/89	36 months
Davis-Besse #3	906	1987	4/1/90	36 months
Erie #2	1,266	1988	4/1/91	36 months

The instant proceeding to determine the impact on rates and service of the delays in the CAPCO construction schedule were assigned to us.

The Commission's order, adopted July 12, 1979, instituting an investigation with respect to Duquesne into the delays in the CAPCO construction schedule states as follows:

> With respect to the CAPCO construction delays, it should first be noted that CAPCO stands for Central Area Power Coordination Group and it is the energy planning group of which Duquesne is a member. In November 1978, CAPCO announced major delays in the construction of seven large electric generating units, ranging from 16 to 18 months. A list of these generating units together with pertinent data relating to them is attached hereto and made a part hereof. Duquesne is a partner in each of these ventures. The extended schedule of construction will increase the cost of those generating units through inflation and through an increased allowance for funds during construction (AFUDC). Further, energy costs will probably be higher as these new base load units will not be on line to serve the customer needs.
>
> We believe that the problem presented by these construction delays merits the Commission's consideration; THEREFORE,
>
> IT IS ORDERED
>
> 1. That a formal investigation is hereby instituted to determine the impact of the CAPCO construction delays upon the rates charged and the service provided by Duquesne Light Company.

In a similar order, adopted July 19, 1979, the Commission instituted a similar investigation with respect

to Pennsylvania Power Company (Penn Power or Company), also a member of CAPCO, which stated, inter alia:

> IT IS ORDERED:
>
> 1. That a formal investigation is hereby instituted to determine the impact of the CAPCO construction delays upon the rates charged and the service provided by Pennsylvania Power Company.

In addition to the Commission's investigations which were docketed at I-790703125 (Duquesne) and I-79070317 (Penn Power), Petitions to Intervene were filed by the Commission Trial Staff, the Office of the Consumer Advocate, the City of Pittsburgh and Mayor Richard S. Caliguiri, the Neighborhood Legal Services Association, United States Steel Corporation, Crucible, Inc, General Motors Corporation, and certain commercial customers, which are owners of buildings, or their agents, located primarily in downtown Pittsburgh (Commercial Complainants).

In response to Petitions for Modification and Reconsideration, the Commission, on November 8, 1979, entered an order clarifying the scope of the Commission's investigations, as follows:

> A thorough evaluation of delays in construction schedules must include an investigation of Duquesne's (Penn Power's) load forecasts, the load forecasts of other CAPCO members, and the local forecasts for the CAPCO system as a whole. A thorough evaluation of the best solutions to construction delays must include the option of stepping-up the schedules of plants under construction, delaying initiation of additional construction, halting construction on some plants, or investing in smaller other fuel plants. Each option must be considered and evaluated in terms of its ultimate impact on Duquesne's (or Penn Power's) customers.

A prehearing conference was held on October 5, 1979. At that time the parties were directed to file statements of issues involved.

In all, twenty-seven (27) days of evidentiary hearings were held between November 20, 1979 and November 18, 1980. The record consists of 3,620 pages of testimony, as well as thousands of pages of Statements and Exhibits.

Duquesne presented the testimony of Mr. Dempler in the area of generation planning, Mr. Atkinson on finances, Messrs. Gilfillan, Grant and Dudt in the area of load forecasting, and finally, Mr. Dunn on operations. On behalf of Penn Power, Mr. Lynn Firestone testified in the area of generation planning, Mr. Owano on financial planning, and Mr. Pazak on load forecasting. For the Office of the Consumer Advocate, Mr. John Stutz testified in the area of load forecasting, and Dr. Richard Rosen in the area of generation planning. In addition, the Companies submitted numerous exhibits in response to written and oral requests of other parties.

The Office of the Consumer Advocate (Consumer Advocate) presented its evidence through two witnesses.

Effective, October 1, 1980, the Commission Trial Staff withdrew its participation in the proceeding.

During the course of the hearings, on January 10 and 11, 1980, the Chief Executive Officers of the CAPCO companies recommended, and on January 22, 1980, the Board of Directors of the various CAPCO companies authorized cancellation of four (4) of the seven (7) nuclear generating units scheduled for construction. The

reasons for the cancellations were explained by the Companies in their news release as follows:

> The political and regulatory uncertainties affecting the future construction of nuclear plants has intensified following the accident at Three Mile Island. Nuclear construction scheduled further in the future carries greater uncertainty of eventual cost. In spite of our convictions regarding nuclear power, this uncertainty has compelled the CAPCO Companies to terminate those nuclear units not yet under actual construction in order to reduce the future risks to our customers and shareholders.

As a result of this decision, the Companies submitted further evidence with respect to the impact of this most recent decision upon the issues in this investigation.

On May 14, 1980, the Companies filed with the Commission a Petition to Terminate the Investigation, stating, in part,

> 13. Prior to the January 22, 1980 cancellation announcement, the parties to the proceeding had not agreed to issue, but rather, while the Companies were submitting testimony on the impact of the cancellation per the Commission Orders, various other parties were alleging an excess capacity, the propriety of continued construction and selection of nuclear fuel. Whether the schedule delays on rates and service as we believe was the Commission's intent or the broader concept of some of the parties as to excess capacity, propriety of construction and selection of fuel, we believe with the cancellation of the four units the purpose and reason for the investigation has terminated. Clearly with the cancellation of these four units there can no longer be any question of excess capacity and if the Commission desires to investigate Penn Power and Duquesne construction program, we respectfully submit that it should be at I.D. 138 which was instituted for

> that purpose and is an open proceeding at which the Companies file annual reports. As to the propriety of construction and selection of fuel we respectfully submit that the Commission has no jurisdiction. This lack of jurisdiction was clearly articulated by Administrative Law Judge Klovekorn in the Philadelphia Electric rate proceeding at R-79060865 in which he held: "It should be noted again that this Commission lacks jurisdiction over the planning and siting of electric generating stations. As a result a utility may plan and construct a generating station such as Limerick without the need for the express approval of this Commission. The first time that the utility must seek this Commission's approval is in the rate proceeding subsequent to its being placed in service . . . (And) this Commission also has no specific jurisdiction also over the selection of the type of fuel used to generate the electricity . . ." (p. 63)
>
> * * *
>
> "It is hornbook law that the Commission is not a superboard of directors managing the affairs of a utility. This Commission was not established for the purpose of telling a utility when to place a generating plant on line, nor is it proper for a quasi-judicial body to work out the ratemaking treatment of a plant, such as Limerick, outside the context of a rate proceeding." (p. 73).
>
> Thus, it would appear that the original allegations of the parties are outside the Commission's jurisdiction and in the event moot by the cancellation of the last four nuclear units.
>
> 14. Furthermore, to continue this investigation is contrary to the public interest. The original premise of the investigation is negated, the ability of the Commission to change the facts is non-existent and the parties would be required.
>
> * * *

CANCELLATION CHARGES

The CAPCO Companies announced on January 23, 1980 the termination of the last four units, i.e., Davis-Besse #2 and #3 and Erie #1 and #2. As was stated to the press by the Chief Executive Officers of the Companies:

> The political and regulatory uncertainties affecting the future construction of nuclear plants has intensified following the accident at Three Mile Island. Nuclear construction scheduled further in the future carries greater uncertainty of eventual cost. In spite of our convictions regarding nuclear power, this uncertainty has compelled the CAPCO companies to terminate those nuclear units not yet under actual construction in order to reduce the future risks to our customers and shareholders.
>
> These decisions are not without risk. Decisions made today affect adequacy of electrical supply in the future. The companies are concerned about the reliability of electric service to their customers in the mid-1980's—particularly by the 1990's.
>
> These concerns are being continually addressed as each company monitors the growth in customer demand in relation to capacity.
> [Duq. Exhibit 13-C at 2]

The Companies request that the cancellation costs relating to the four cancelled nuclear plants be amortized over a ten-year period. Duquesne's investment in those units at December 31, 1979 were $31,115,727. The claim for a ten-year amortization of $3,111,573 per year had been requested.

In regard to the amortization of $56 million dollar cancellation cost requested by Cleveland Electric

Illuminating Company in relating to the same generating plants, the Ohio Commission stated:

> In determining whether these expenditures were prudent, one must bear in mind what is and what is not at issue. No one disputes that the 1973 decision to embark on the construction in question was reasonable as it was based on the best data available. . . Similarly, no one disputes that the decision to terminate construction was reasonable, given the intervening decline in growth expectations and the uncertainties which now attend the construction of nuclear units. Thus the only real question is whether the decision to terminate should have been made sooner.
> [Companies' Reply Brief, p. 125; Re Cleveland Illuminating Company, Case No. 79-537-EL-AIR, mimeo, at 28-29]

The cancellation of the CAPCO four nuclear plants is not an isolated occurrence. In the past several years a number of nuclear units have been cancelled in the United States, including:

Year Unit Cancelled	Unit	Company
1977	Slurry 3	Virginia Elec. & Power
	Slurry 4	Virginia Elec. & Power
	Barton 1	Alabama Power
	Barton 2	Alabama Power
	Douglas Point 1	Potomac Elec. Power
1978	Sundesert 1	San Diego Gas & Elec.
	Sundesert 2	San Diego Gas & Elec.
	South river 1	Carolina P. & L.
	South River 2	Carolina P. & L.
	Haven 2	Wisconsin Elec. Power
	Zimmer 2	Cincinnati Gas & Elec.
	Atlantic 1	Pub. Service Elec. & Gas
	Atlantic 2	Pub. Service Elec. & Gas
	Unnamed Floating 1	Pub. Service Elec. & Gas
	Unnamed Floating 2	Pub. Service Elec. & Gas
	Blue Hills 1	Gulf States Utility
	Blue Hills 2	Gulf States Utility

Year Unit Cancelled	Unit	Company
1979	Greene County 1	Pow. Auth. State of N.Y.
	Palo Verde 4	Arizona Pub. Serv.
	Palo Verde 5	Arizona Pub. Serv.
	Tyrone 1	Northern States Power
	San Joaquin 1	L. A. Dept. of W. & P.
	San Joaquin 2	L. A. Dept. of W. & P.
	NEP 1	New England Power
	NEP 2	New England Power
1980	Davis-Besse 2	Toledo Edison
	Davis-Besse 3	Toledo Edison
	Erie 1	Ohio Edison
	Erie 2	Ohio Edison
	Sterling	Rochester G. & E.
	Jamesport 1	Long Island Lighting
	Jamesport 2	Long Island Lighting
	Haven 1	Wisconsin Elec. Power
	Greenwood 2	Detroit Edison
	Greenwood 3	Detroit Edison

[See Duquesne Exhibit No. AA and Duquesne Light Company's Petition to Terminate]

1981	Carysville	Gulf Power
	Sterling	Rochester Gas & Elec.
	North Anna	Virginia Elec. & Power
	Montague	Connecticut Power & Light
	Koshkonong	

[See 1982 Annual Report Section of Public Utility Law pp. 64-70]

Four possible options, as exercised by various regulatory commissions, are available to the Commission: (1) no amortization or allowance of cancellation costs; (2) amortization of cancellation costs with unamortized portion included in rate base for return; (3) amortization of cancellation costs with unamortized portion not

included in rate base; and (4) amortization of cancellation costs with the exception of AFUDC portion under either (2) or (3).

Initially, the Commission must determine whether the claim for amortization of cancellation costs, in any fashion, should or should not be allowed as a matter of principle.

There is no question that the overwhelming weight of authority from other jurisdictions supports the principle that an expense prudently incurred, even for a project later cancelled or abandoned because of changed conditions, is a proper expense for ratemaking purposes. The write-off through expenses of abandoned generating facilities is widely accepted among state commissions.

The Public Utility Commission of Texas, at Docket No. 2676, January 9, 1979 approved such costs, saying:

> . . . The Examiner does not feel that it is inappropriate for the Commission to allow a utility to recover selected past investment losses from its ratepayers when the circumstances of the investment, weighed carefully, indicate that insulating the shareholders from the losses provides a necessary incentive for the utility to take reasonable investment risks for the benefits of its ratepayers. Clearly, the Commission felt that the Allen's Creek investment warranted such special treatment.

The Federal Energy Regulatory Commission (FERC), at ER77-533 (2/12/79), in allowing Louisiana Power & Light Company to amortize its investment in two cancelled nuclear units know as St. Rosalie of $13,600,000 over five years noted:

> The mere fact that the St. Rosalie project has been abandoned does not prove that L P & L's

> decision to initiate the project was a "mistake" at the time it was made. Rather, it simply resulted from a change of circumstances which could not reasonably have been forseen. (p. 32)

FERC, in permitting New England Power, at ER76-304, et al, by order of 7/19/79 to amortize its $13,150,000 expenditure on Salem Harbor #5 over a five year period, stated (p. 33):

> It is evident that unless security holders are shielded against risk of losses resulting from aborted projects by way of inclusion in cost of service, the cost of capital will be higher to an extent necessary to compensate for the additional risk. Thus, if rate of return is required to be sufficiently high to enable the public utility to attract capital, the risk of such losses must be borne by the ratepayers either directly. (through cost of service) or indirectly. (through rate of return) . . .

The Michigan Public Service Commission, in allowing Consumers Power Company to recover $13.7 million in unrecovered costs associated with the abandoned Quanicassee nuclear facility, said:

> Applicant's decision to commence planning, site acquisition, site improvement and to incur contractual commitments for architectural, engineering and construction work on Quanicassee project was reasonable and prudent in light of Applicant's load-forecasts of the future demands upon its generating system in the 1980's and the need to construct generation facilities to adequately serve its present and future customers and to provide for sufficient reserve capacity for that purpose . . .
>
> Applicant's decisions were reasonable and prudent in light of the demonstrated need to apply whatever capital funding is obtainable to the completion of other generating facilities now in progress . . .

> and which are scheduled for completion prior to the last projected in-service dates of the Quanicassee units.
> [Consumer Power Co., Case No. F-700, mimeo at 5-6 (February 10, 1975)]

In an attempt to balance equitably the responsibility as between investors and consumers in connection with cancellation costs of abandoned projects the Public Utilities Commission of California at Decision No. 90405, June 5, 1979, stated:

> . . . While we are cognizant of the carrying costs of money on hand, for any project or cost not given rate base treatment; on the other hand, we are also concerned about the burden we are placing on the ratepayers to pay for an abandoned project. While the burden on the shareholders is substantial, the burden on the ratepayers is also substantial. We believe load-growth forecasts of the future demands upon its generating system in the 1980's and the need to construct generation facilities to adequately serve its present and future customers and to provide for sufficient reserve capacity for that purpose. In addition, the initiation of the project at that time was reasonable and prudent in view of the potential advantages offered by nuclear generating facilities and the lengthy approval and construction period necessary prior to completion of those facilities.
>
> Applicant's decisions to defer and ultimately cancel the Quanicassee project were reasonable and prudent in view of its revised load growth forecasts, its inability to raise the huge amounts of necessary capital in the marketplace at reasonable cost to continue the project, its deteriorating financial condition . . . and the further rigidity of nuclear licensing requirements thereby extending the projected in-service dates of the project and in-

creasing the enormous costs projected for completion. In addition that adherence to our practice of allowing recovery of abandonment costs form ratepayers while denying rate base treatment, is an equitable solution to a difficult problem. In addition, in denying rate base treatment of the unamortized nonsite costs, we will adopt a five-year amortization period rather than the ten-year period recommended by the Staff and certain other parties.

In *Central Main Power Co. v. Public Utility Commission*, the Maine Supreme Court, at 433 A.2d 331 (ME 1981), affirmed a Commission order which allowed the company to amortize the costs of a cancelled nuclear plant over a five-year period, but denied recovery of AFUDC and denied a return on the unamortized balance. The court held that this constituted a reasonable balancing of the interests of ratepayers and stockholders.

In *Gulf Power Co. v. Cresse*, the Supreme Court of Florida (No. 60, 437 Jan. 28, 1982) affirmed a decision of the Public Service Commission allowing Gulf Power to amortize the costs of its cancelled Carysville generating plant and to include the unamortized balance in rate base.

The New York Public Service Commission ordered that the costs of the cancelled Sterling nuclear plant be amortized and that the plant owners be allowed a return on the unamortized balance [Rochester Gas & Elec. Corp. Case 27794, Opinion 82-1 (Jan. 12, 1982)].

The Virginia State Corporation Commission recently authorized Virginia Electric & Power Company to amortize the costs of its cancelled North Anna 4 nuclear unit over a ten-year period, but refused to permit a return on the unamortized balance, holding that this

would place too great a burden on ratepayers. [Case No. PUE 810025 (Aug. 24, 1981)].

Similar decisions allowing amortization over varying periods and conditions were reached in Missouri [Union Electric Co., Case No. ER 77-154 (Jan. 19, 1977)]; North Carolina [Carolina Power & Light Co., Docket No. E-2, Sub. 264 (Feb. 20, 1976); Virginia Electric and Power Co., Docket No. E-22, Sub. 224 (Aug. 23, 19780)]; Rhode Island [Narragansett Electric Co., Docket No. 744-335 (Oct. 31, 1975)]; Wisconsin [Wisconsin Electric Power, et al, Case 05-CE-3 (2/14/80)]; and South Dakota [Northern States Power, Case No. F-3069 (Dec. 30, 1976)].

There have been, however, a number of decisions where recovery has been disallowed for abandoned projects. The Arizona Corporation Commission, in a rate case refused recovery for costs to Arizona Public Service Company for costs associated with its interest in the cancelled units 4 and 5 of the Palo Verde nuclear projects. The Commission refused any recovery of sunk costs, notwithstanding its Staff's recommendation that a five-year amortization be allowed [Docket No. U-1345, Decision 51009 (May 30, 1980)]. The Commission's decision was affirmed by the Superior Court of Maricopa County on the ground that it did not constitute an abuse of discretion.

In Ohio the Public Utility Commission allowed Cleveland Electric Illuminating Company [CEI] amortization over a ten-year period of its investment of $56 million in the same four terminated nuclear power plants as involved in this proceeding. [Case No. 79-537 EL-AIR] The Supreme Court of Ohio [at 67 Ohio St 2d 153, NE 2d (1981)], however, on statutory

grounds, reversed the Commission rejecting such amortization. Appeal was denied by The United States Supreme Court for want of a properly presented federal question on January 25, 1982 [50 U.S.L.W. 3590].[3]

It must also be determined by the Commission as to whether the 1973 decision to embark on the construction of Davis-Besse #2 and #3 and Erie #1 and #2, and the 1980 decision to cancel the construction of these four nuclear units, were reasonable.

In this connection, we must view the decision to construct these units in the proper time context. It must be remembered that in 1973 the CAPCO load forecast was about 6% per year. In 1973 before the Arab oil embargo, the companies had every reason to believe that the trends experienced in the years since World War II in peak growth would continue. It seemed reasonable at that time to project continued growth for at least the next ten years.

A reserve analysis study reported in July 1973 to the CAPCO Executive Committee concluded that:

a. The CAPCO Group was large enough to sustain (economically) the reserve requirements associated with the largest generating unit available.

[3]The day following the Ohio Supreme Court decision Moody reduced the rating of CEI bonds from Aa to A.

Subsequently, Ohio Edison Company, another affected company, filed application for emergency rate relief. The day after Ohio Edison filed its application for emergency relief, the Commission granted a temporary rate increase in the amount of $90 million on an annualized basis, effective August 1, 1981. All parties (including the Consumers' counsel) stipulated that without emergency relief, the company would be in financial jeopardy. The Commission granted the increase upon its finding that in its absence, Ohio Edison's ability to render service would be impaired or the company would be financially imperiled. [Case No. 81-898-EL-AEM (July 31, 1981)].

b. Potential benefits of better availability of comparatively small generating units were outweighed by the economies of scale.

c. The economic analysis of plans using various sizes of generating units ranging from 400 MW to 1200 MW shows that 1200 MW units were economically superior to smaller sizes for the CAPCO system in the early 1980's.

d. Nuclear fueled generating units were economically preferred for the CAPCO system in the early 1980's.

With respect to the latter, a comparision was made between alternate long range expansion plans using a series of 1200 MW nuclear and a series of 1200 MW coal-fired units. The result of this comparison showed that nuclear units showed a 20% lower percent worth of customer costs over the period 1981-2005 as compared with coal. The preference of nuclear over coal in this study was on the basis of the lowest cost to the customer.

These four units were committed simultaneously due to the need for additional capacity over the projected construction time requirements, the then expected eight to ten year lead time for installing nuclear generating units, the anticipated economies which would be possible by constructing two or more generating units at the same site and the expected benefits, in terms of licensing which would accrue to a multiple commitment of nuclear units.

The evidence clearly supports the conclusion that the decision to embark upon the construction of these four nuclear plants was prudent.

We turn next to the question as to whether these four nuclear plants should have been terminated earlier.

Dr. Rosen contends that as early as November 1977, CAPCO should have realized that these four nuclear units should have been cancelled.

Following the Arab oil embargo and the recession of 1974, many changes and trends in the economy had occurred and the financial constraints associated with the capacity program were becoming obvious. Reviews were conducted and changes in the program were agreed upon as a result of rapidly increasing construction costs, reduction in load demand, and difficulty in raising necessary financing. These reviews resulted in decisions to modify the construction program in 1975, 1977, 1978 and early 1980. As Mr. Firestone testified (prior to the January 1980 cancellations):

> . . . in each of those instances the CAPCO parties were faced with a situation that the construction program that was ongoing was more than they could sustain financially, and therefore some action was necessary. [Tr. at 499]

Studies by CAPCO, however, reaffirmed that nuclear programs were still economically more attractive. It was felt, however, that the construction program could continue with delays to accommodate the financial resources.

The Three Mile Island accident in 1979, in effect, broke the back of construction plans for Davis-Besse #2 and #3 and Erie #1 and #2. As a result of further study and evaluation by the CAPCO Executive Committee, it was determined that as a result of the Three Mile Island accident CAPCO would experience continual re-engineering, re-manufacture of fabricated parts and retrofitting of such construction as may take place, with adverse effects on the cost to the consumer.

CAPCO decided to cancel these last four nuclear plants on which preliminary costs were expended.

The additional requirements placed on nuclear units by the Nuclear Regulatory Commission as a result of the Three Mile Island accident had substantially increased their cost. Construction permits had not been issued for these units. It was not possible, in today's political and regulatcry climate, to determine with any degree of certainty when or if such permits would be granted. Continued construction of these units would require necessary expenditures of capital money with no assurance that such expenditures would result in units which could be licensed to operate.

On the basis of all the evidence, we find that the CAPCO decisions in regard to the Davis-Besse #2 and #3 and Erie #1 and #3 nuclear units, at every stage to their cancellation, were reasonable and prudent.

While this Commission is not bound by the decisions in other jurisdictions as to the amortization of costs in connection with cancelled nuclear units, we are persuaded that the overwhelming weight of such authority, allowing amortization of such sunk costs, is the proper and reasonable course to follow. Accordingly, we recommend that Duquesne and Penn Power be allowed to amortize their portion of such cancellation costs, the amount of which should be determined in appropriate rate cases, over a ten-year period. However, we recommend, as a proper balancing between investor and consumer interests, that the unamortized balance not be included in rate base for a return.

It must be noted that in regard to Duquesne has paid its costs in connection with the cancelled plants for the past eight years, and will continue to do so over the

next ten years. The investors will pick up more than 50% of the associated costs even if the Company's claim is paid in full. The ratepayer will get the full tax effect of the cancellation.

RECOMMENDATION

It is hereby recommended to the Commission:

1. That the Commission's investigation at Docket Nos. I-79070315 and I-79070317 be terminated.

2. That the Commission allow Duquesne Light Company and Pennsylvania Power Company to amortize their respective portions of the cancellation costs relating to Davis-Besse #2 and #3 and Erie #1 and #2, in appropriate rate cases in such amount as therein determined, over a period of ten (10) years with no return on the unamortized portion thereof.

/s/ JOSEPH P. MATUSCHAK
JOSEPH P. MATUSCHAK
Administrative Law Judge

October 15, 1982

APPENDIX I

Order of the Pennsylvania Public Utility Commission Adopting the CAPCO Investigation.

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17120

Public Meeting held January 7, 1983

Commissioners Present:
Susan M. Shanaman, Chairman, dissenting
Michael Johnson, dissenting
James H. Cawley
Linda C. Taliaferro
Clifford L. Jones

Investigation Upon the Commission's Motion into the Delays in the CAPCO Construction Schedule.	I-79070315 I-79070317

O R D E R

By the Commission:

We adopt as our action the Report of Investigation of Administrative Law Judge Matuschak dated October 15, 1982, and that Exceptions be denied; THEREFORE,

It Is Ordered:

1. That the investigations at I-79070315 and I-79070317 be terminated.

2. That Duquesne Light Company and Pennsylvania Power Company be allowed to amortize their respective portions of the cancellation costs relating to Davis-Besse #2 and #3 and Erie #1 and #2, in appropriate rate cases in such amount as therein determined, over a period of ten (10) years with no return on the unamortized portion thereof.

By the Commission,

/s/ Jerry Rich

Jerry Rich
Secretary

(SEAL)
Order Adopted: January 7, 1983
Order Entered: January 13, 1983

APPENDIX J

Documents Relating to FERC
Treatment of Involved Costs.

OHIO EDISON COMPANY
76 SOUTH MAIN STREET, AKRON, OHIO 44308 • 216-384-5296

March 11, 1980

Mr. L. H. Drennan, Jr., Chief Accountant
Federal Energy Regulatory Commission
825 North Capitol Street, N.E.
Washington, D.C. 20426

Dear Mr. Drennan:

In September 1967, the Central Area Power Coordination Group (CAPCO Companies) consisting of Ohio Edison Company, Pennsylvania Power Company, The Cleveland Electric Illuminating Company, Duquesne Light Company and The Toledo Edison Company announced a program for joint development of power generation and transmission facilities. Each of the companies is obligated to pay a share of the costs of any such jointly owned generating facilities in the same proportion as its ownership interest therein. Included in such program are two nuclear units at the Davis-Besse Power Plant site near Port Clinton, Ohio, and two nuclear units at the Erie Power Plant site in Berlin Heights, Ohio. Ohio Edison Company and its wholly owned subsidiary, Pennsylvania Power Company, has an ownership interest of 41.88% in each of these units.

The plans to construct these units were terminated by the CAPCO Companies in January 1980. The political and regulatory uncertainties affecting the future construction of nuclear plants following the Three Mile Island accident, which in turn carries a greater uncertainty of eventual costs, compelled the CAPCO Companies to terminate these nuclear units that were essentially in the design stage in order to reduce the future

costs to our customers and shareowners. The Davis-Besse units were also in an initial construction phase.

Pursuant to Paragraph C of Account 182, Extraordinary Property Losses, of the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission (FERC) for Public Utilities and Licensees subject to the provisions of the Federal Power Act, we are hereby requesting permission to use Account 182, Extraordinary Property Losses, to record the accumulated construction costs applicable to Davis-Besse Unit No. 2 and No. 3 and Erie Unit No. 1 and No. 2, and any other costs or recoveries which are experienced.

The amount of $85,410,506 is to be debited to Account 182, Extraordinary Property Losses and credited to Account 107, Construction Work in Progress.

Permission will be sought of The Public Utilities Commission of Ohio (PUCO) and FERC to recover these costs in rates. Should such recovery be granted, the Company would amortize them over the period ordered by the PUCO and FERC to Account 407, Amortization of Property Losses. The income tax effects of the losses shall be deferred and amortized over the same period using Accounts 283, 410.1 and 411.1.

Inasmuch as Pennsylvania Power Company is a wholly owned subsidiary of Ohio Edison Company, this request for like treatment is also being made on their behalf in the amount of $14,761,397.

Please advise if you need any further information in order to grant our request.

Sincerely,

/s/ W. B. Marvin
Comptroller

Duquesne Light Company
435 Sixth Avenue
Pittsburgh, Pennsylvania
15219

March 13, 1980

Federal Energy Regulatory Commission
825 North Capital Street, N.E.
Washington, D.C. 20426

Attention: Mr. Kenneth F. Plumb
Secretary

Gentlemen:

Duquesne Light Company ("Duquesne") hereby applies to the Commission for authorization to use Account 182, Extraordinary Property Losses, to record its accumulated construction costs incurred to date, and other costs or recoveries subsequently incurred, resulting from the termination, in January, 1980, by the Companies in the Central Area Power Coordination Group of plans to construct four nuclear generating units. Duquesne's corporate action to terminate construction of these units was taken at a meeting of its Board of Directors on January 22, 1980.

The affected generating units are Units 2 and 3 at the Davis-Besse Nuclear Power Station, near Port Clinton, Ohio, and Units 1 and 2 of the Erie Nuclear Plant Site at Berlin Heights, Ohio. All of the units were in the design stage; the Davis-Besse units were also in an initial construction phase. Duquesne's ownership interest in each unit was 13.74%.

As of December 31, 1979, the costs to be recorded in Account 182 were $31,155,727, representing Duquesne's share of the gross construction costs at that date. Other costs or recoveries subsequently incurred will also be recorded in Account 182.

The Company intends to amortize the costs accumulated in Account 182 to Account 407, Amortization of Property Losses, over a period of 120 months or any different period if ordered by the Pennsylvania Public Utility Commission. Because of a timing difference between book and income tax deductibility, the appropriate deferred tax accounts will be used. The Company will seek approval of this amortization plan from the Pennsylvania Public Utility Commission which also has accounting jurisdiction over the Company and has primary rate making jurisdiction over the Company's rates. Similar approval will be requested from your Commission in the future when a request is made for a change in jurisdictional rates.

Your prompt consideration and approval of this request will be appreciated. Please let us know if additional information is desired.

Very truly yours,

/s/ CHARLES M. ATKINSON
Vice President—Fiscal

OHIO EDISON COMPANY
76 SOUTH MAIN STREET, AKRON, OHIO 44308 • 216-384-5296

March 24, 1980

Mr. L. H. Drennan, Jr., Chief Accountant
Federal Energy Regulatory Commission
825 North Capitol Street, N.E.
Washington, D. C. 20426

Dear Mr. Drennan:

As requested by Mr. Jonas Green in a recent phone conversation, we are furnishing this additional information with respect to the request embodied in my letter dated March 11, 1980 to use Account 182, Extraordinary Property Losses for costs related to termination of construction of four nuclear units.

The Company and Pennsylvania Power Company have incurred, as stated in my original letter, expenditures of $85,410,506 and $14,761,397, respectively, relating to these units. We anticipate that there will be some additional minor charges as yet unbilled and claims by suppliers for cancellation charges, currently undeterminable and subject to negotiation and possible litigation.

Ohio Edison Company and its subsidiary Pennsylvania Power Company do not at present have any rates in effect which includes any portion of the termination costs.

Ohio Edison Company intends to file requests for rate increases in early May 1980 with The Public Utilities Commission of Ohio (PUCO) for retail customers and with the FERC for wholesale customers. We shall ask each to recognize termination costs related to these units and to include in such rates an amortization of

these costs over a reasonable period. A ten-year amortization period will be requested. Amortization would begin with effective dates of the appropriate rate orders. The rates over which the PUCO has jurisdiction could not be put into effect until about March 1981. The wholesale rates over which the FERC has jurisdiction could be put into effect subject to refund 90 days after filing which would be sometime in September 1980. Pennsylvania Power Company will seek consideration of these termination costs in their next request for rate increases with the Pennsylvania Public Utility Commission in 1981 and with the FERC, possibly in late 1980 or early 1981.

Sincerely,

/s/ W. B. MARVIN

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON 20426

IN REPLY REFER TO:
OCA-AS

April 18, 1980

Mr. Charles M. Atkinson
Vice President-Fiscal
Duquesne Light Company
435 Sixth Avenue
Pittsburgh, Pennsylvania 15219

Dear Mr. Atkinson:

We have reviewed your request submitted by letter dated March 13, 1980, for Commission approval to use Account 182, Extraordinary Property Losses, to defer the costs incurred relative to the cancellation of the proposed Units 2 and 3 at the Davis-Besse Nuclear Power Station and Units 1 and 2 at the Erie Nuclear Plant.

Your request to use Account 182 to defer the costs incurred in connection with the four cancelled nuclear units is approved. The costs, amounting to $31,115,727, are to be charged to Account 182 and amortized to Account 407, Amortization of Property Losses, over a ten-year period beginning with the effective date of rates in your next rate filing, but not later than January 1, 1981. The income tax effects of the loss are to be deferred in Account 283, Accumulated Deferred Income Taxes, and amortized to Account 411.1, Provision for Deferred Income Taxes—Credit, Utility Operating Income, concurrent with the amortization of the loss.

Should any gains or recoveries be realized relative to the cancellation of the construction of the proposed Units 2 and 3 at the Davis-Besse Nuclear Power Sta-

tion and Units 1 and 2 at the Erie Nuclear Plant, such amounts shall be utilized to reduce the unamortized amount of the loss.

If additional costs are incurred relative to the cancellation, they may be included in Account 182 and amortized over the remaining period of the original amortization period. In the event that such additional charges are incurred, you shall notify this office as to the nature and amount of the costs.

The entries authorized to record and amortize the loss and the related income tax effects are for accounting purposes only and are in no way to be construed as constituting a final judgment on or an indication of the prudency of the commitments, expenditures or management's decision relative to the planning, construction or cancellation of the plants that would mandate inclusion of the charges in future rate proceedings. In the event that the charges are disallowed in future rate proceedings, before this or any other regulatory body, the unamortized balance of the loss shall be charged to Account 426.5, Other Deductions, in the year of such disallowance.

Sincerely yours,

/s/ L. H. DRENNAN, JR.
Chief Accountant

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON 20425

IN REPLY REFER TO:
OCA-AS

April 28, 1980

Mr. W. B. Marvin
Comptroller
Ohio Edison Company
76 South Main Street
Akron, Ohio 44308

Dear Mr. Marvin:

We have reviewed your request submitted in behalf of Ohio Edison Company and Pennsylvania Power Company by letter dated March 11, 1980, and subsequent letter of March 24, 1980, for Commission approval to use Account 182, Extraordinary Property Losses, to defer the costs incurred relative to the cancellation of the proposed Units 2 and 3 at the Davis-Besse Nuclear Power Station and Units 1 and 2 at the Erie Nuclear Plant.

Your request to use Account 182 to defer the costs, amounting to $85,410,506 for Ohio Edison Company and $14,761,397 for Pennsylvania Power Company, incurred in connection with the four cancelled nuclear units is approved. The amounts for the respective companies shall be charged to Account 182 and amortized to Account 407, Amortization of Property Losses, over a ten-year period, beginning with the effective date of rates in your next rate filings, but not later than January 1, 1981. The income tax effects of the loss are to be deferred in Account 283, Accumulated Deferred Income Taxes—Other, and amortized to Account 411.1, Provision for Deferred Income Taxes—Credit, Utility Oper-

ating Income, concurrent with the amortization of the loss.

Should any gains or recoveries be realized relative to the cancellation of the construction of the proposed Units 2 and 3 at the Davis-Besse Nuclear Power Station and Units 1 and 2 at the Erie Nuclear Plant, such amounts shall be utilized to reduce the unamortized amount of the loss.

If additional costs are incurred relative to the cancellation, they may be included in Account 182 and amortized over the remaining period of the original amortization period. In the event that such additional charges are incurred, you shall notify this office as to the nature and amount of the costs.

The entries authorized to record and amortize the loss and the related income tax effects are for accounting purposes only, and are in no way to be construed as constituting a final judgment on or an indication of the prudency of the commitments, expenditures or management's decisions relative to the planning, construction or cancellation of the plants that would mandate inclusion of the charges in future rate proceedings. In the event that the charges are disallowed in future rate proceedings, before this or any other regulatory body, the unamortized balance of the loss shall be charged to Account 426.5, Other Deductions, in the year of such disallowance.

Sincerely yours,

/s/ L. H. Drennan, Jr.
Chief Accountant

OHIO EDISON COMPANY
76 SOUTH MAIN STREET, AKRON, OHIO 44308 • 216-384-5296

May 13, 1980

Mr. L. H. Drennan, Jr., Chief Accountant
Federal Energy Regulatory Commission
835 North Capitol Street, N.E.
Washington, D. C. 20426

Dear Mr. Drennan:

I have reviewed your authorization dated April 28, 1980 (OCA-AS) approving the requests of Ohio Edison Company and its subsidiary, Pennsylvania Power Company (Penn Power), to defer the costs incurred in connection with four cancelled nuclear units to Account 182 and to amortize the costs to Account 407 over a ten-year period, beginning with the effective date of rates in the companies' next rate filings, but not later than January 1, 1981. We request that you remove the requirement for amortization to begin by January 1, 1981. It is very unlikely that the effective date of rates in either company's rate filings with The Public Utilities Commission of Ohio (PUCO) or the Pennsylvania Public Utility Commission (PPUC) would be prior to January 1, 1981.

On May 7, 1980, Ohio Edison filed an application with the PUCO for a rate increase which includes recovery of the costs of the terminated units. Under Ohio law, requested rates may be collected subject to refund if the PUCO does not make a decision within 275 days after a case is filed. This time lag would peg the expected recovery to begin on or about March 1, 1981. Penn Power had filed a request for an increase in its rates with the PPUC prior to the termination of the

four nuclear units and was unable to include the costs in its current rate application. The PPUC is expected to render its decision on such request on or about July 1, 1980. Thus, Penn Power expects to make application to the PPUC in April 1981 for a rate increase which would include the costs of the terminated units. Penn Power would expect to begin recovering such costs on or about January 1, 1982.

The purpose of deferring such costs and classifying them as an asset is due to the future economic benefit which results from the reasonable assurance of recoverability from customers. This is in accordance with generally accepted accounting principles. The Addendum to Accounting Principles Board Opinion No. 2 states that:

> If a cost incurred by a regulated business during a given period is treated for rate-making purposes by the regulatory authority having jurisdiction as applicable to future revenues, it may be deferred in the balance sheet at the end of the current period and written off in the future period or periods in which the related revenue accrues, even though the cost is of a kind which in a nonregulated business would be written off currently.

Amortizing these costs beginning January 1, 1981, without having received rate treatment, would clearly be inconsistent with the purpose for originally deferring the costs. In addition, amortization before recovery from customers may improperly infer that the costs will not be recoverable, which may have an adverse effect on the perceptions of persons in the securities market where we must frequently compete for funds. I am certain that this is not the FERC's intent and again request that you remove the requirement for amortization to begin no later than January 1, 1981.

Your usual prompt attention will be greatly appreciated.

Sincerely,

/s/ W. B. Marvin
Comptroller

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON 20426

IN REPLY REFER TO:
OCA-AS

June 27, 1980

Mr. W. B. Marvin
Comptroller
Ohio Edison Company
76 South Main Street
Akron, Ohio 44308

Dear Mr. Marvin:

We concur with your request dated May 13, 1980, regarding our April 28, 1980 letter to you. Accordingly, the second sentence of the second paragraph of our letter regarding the loss on the Davis-Besse and Erie Units is amended to read:

> The amounts for the respective companies shall be charged to Account 182 and amortized to Account 407, Amortization of Property Losses, over a ten year period beginning with the date rates in your next rate filing which provides for recovery of the property loss become effective.

Sincerely yours,

/s/ L. H. Drennan, Jr.
Chief Accountant

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON 20426

IN REPLY REFER TO:
OCA-AS

July 10, 1980

Mr. Charles M. Atkinson
Vice President-Fiscal
Duquesne Light Company
435 Sixth Avenue
Pittsburgh, Pennsylvania 15219

Dear Mr. Atkinson:

As a participant in the Davis-Besse Nuclear Power Station Units 2 and 3 and the Erie Nuclear Power Plant Units 1 and 2, which have been cancelled, you were directed to treat the unrecovered costs relative to such units as an extraordinary property loss by our letter to you dated April 18, 1980. Our authorization further directed that amortization of the loss commence "with the effective date of rates in your next rate filing, but not later than January 1, 1981."[1]

We have been requested by Ohio Edison, Pennsylvania Power Company and The Toledo Edison Company to amend our authorization to them regarding the loss by deleting the requirement that amortization commence no later than January 1, 1981. The amendment was requested so as to allow amortization to coincide with rates which would include recovery of the amortization charges. Their requests have been granted.

So as to provide fair and equitable treatment, the second sentence of the second paragraph of our April 18 letter to you is amended to read:

[1]Participants are Ohio Edison Company, Pennsylvania Power Company, Cleveland Electric Illuminating Company, Duquesne Light Company and The Toledo Edison Company. All participants were directed to treat the loss in the same manner.

The amounts shall be charged to Account 182 and amortized to Account 407, Amortization of Property Losses, over a ten year period beginning with the date rates in your next rate filing which provides for recovery of the property loss become effective.

All other provisions of our letter remain in effect.

Sincerely yours,

/s/ L. H. Drennan, Jr.
Chief Accountant

Duquesne Light Company
435 Sixth Avenue
Pittsburgh, Pennsylvania
15219

CHARLES M. ATKINSON
Vice President-Fiscal

May 13, 1982

Federal Energy Regulatory Commission
825 North Capitol Street, N.E.
Washington, D.C. 20426

Attention: Mr. L. H. Drennan, Jr.
Chief Accountant

Dear Mr. Drennan:

In a letter to the Commission dated March 13, 1980, (copy attached) Duquesne Light Company ("Duquesne") requested authorization to use Account 182, Extraordinary Property Losses, to record its accumulated construction costs and other costs related to the termination, in January 1980, of four nuclear generating units then under construction: Davis-Besse Nuclear Power Station Units 2 and 3, and Erie Nuclear Plant Units 1 and 2.

Such authorization was granted in a letter dated April 18, 1980 and a follow-up clarifying letter of July 10, 1980 (copies attached).

Your letter of April 18, 1980 directed that, in the event additional charges are incurred, Duquesne shall notify your office as to the nature and amount of the costs. That provision is the reason for this letter.

In addition to the original construction costs of $31,115,727, there have been minor amounts charged to Account 182 representing subsequent billings by subcontractors. The balance of original construction costs

in Account 182 at March 31, 1982 was $31,447,067. None of the cancellation costs have been amortized to date because the Pennsylvania Public Utility Commission has not ruled on Duquesne's request to recover such amortization through base rates.

Claims against Duquesne made by The Babcock & Wilcox Company, the principal contractor for the four units, were recently settled. The Settlement Agreement calls for a payment by Duquesne to Babcock & Wilcox on or prior to April 30, 1982, in the aggregate amount of $3,091,500 in settlement of the claims with respect to all four units. The Settlement Agreements, however, contain confidentiality clauses requiring that the amount of the settlement not be disclosed to third parties. In light of those clauses, we respectfully request that the Commission make every reasonable attempt to keep the amount of the settlement confidential.

The $3,091,500, when paid to Babcock & Wilcox, will be placed in Account 182 in compliance with the prior approval contained in your April 18, 1980 letter.

Sincerely,

/s/ C. M. Atkinson

PENNSYLVANIA POWER COMPANY

Direct Dial 412-656-5382

September 6, 1983

Mr. Kenneth F. Plumb, Secretary
Federal Energy Regulatory Commission
825 N. Capitol Street, N.E.
Washington, DC 20426

Re: Docket No. ER81-779

Dear Secretary Plumb:

Administrative Law Judge Thomas I. Megan's Initial Decision of June 20, 1983 in the above docket directed Pennsylvania Power Company to file with the Commission details of the costs of cancellation of four nuclear units (Initial Decision, mimeo pp. 24-25). Enclosed are 14 copies of the details of such costs.

Copies of this filing are being provided to all parties in this docket.

Sincerely,

/c/ Stephen L. Feld

Stephen L. Feld
Attorney

PENNSYLVANIA POWER COMPANY

Total Expenditures Incurred on Cancellation of Proposed Erie Nuclear Units 1 & 2 and D. Besse Nuclear Units 2 & 3 as reflected in Account 182, Extraordinary Property Losses

	Erie #1	Erie #2	DB #2	DB #3	Total
As at December 31, 1980					
Direct Cost	(1) 3,997,844	(1) 1,937,628	(2) 4,317,723	2,045,886	12,299,081
AFUDC	670,615	464,633	715,394	368,453 (3)	2,219,095
Other Costs	—	100	3,238	3,236	6,574
As at 12/31/80	4,668,459	2,402,361	5,036,355	2,417,575	14,524,750
January 1, 1981 through August 31, 1983					
Direct Cost	615,461	49,973	895,764	15,680 (4)	1,576,878
Total Costs as at August 31, 1983	5,283,920	2,452,334	5,932,119	2,433,255	16,101,628

NOTES: (1)—See Exhibit 1
(2)—See Exhibit 2
(3)—AFUDC capitalized as of December, 1979.
(4)—See Exhibit 3

Exhibit 1

Erie Nuclear Units 1 and 2 Total Expenditures as at December 31, 1980

Vendor	Erie Nuclear Unit 1	Erie Nuclear Unit 2	Purpose
Commonwealth & Associates	20,216,448	20,315,353	Outside Engineering Services
Gilbert & Associates	621,855	621,856	Outside Engineering Services
Townsend & Bottum	2,887,763	2,830,546	Pre-Construction Eng. & Consultants
General Atomic	1,450,000	1,450,000	Preliminary N.S.S.
Babcock & Wilcox	29,779,236	1,448,623	Progress Payments N.S.S. System
Dr. Frank O'Hara	1,750	1,750	Consultant
General Electric Company	3,188,540	—	Progress Payment—Turbogenerator System
Westinghouse	15,207	15,207	Design Revision Study
Southwest Research	35,311	35,311	Consultants
C. A. Accounting Services	103,672	103,638	Commonwealth Accounting Services
Tera Corporation	49,157	49,157	Consultants
Purolator Corporation	2,618	2,579	Courier Service
Toledo Edison Company	4,275	4,248	Engineering
Shaw, Pittman, Potts & Trowbridge	271,472	279,375	Licensing & siting legal fees
Proton Consultants	28,082	28,082	Consultants
Fincum-Marcini	3,972	3,972	Court Reporters
E.D.S. Nuclear	95,850	—	Consultants
Pickard, Lowe & Gerrick	58,692	47,697	Licensing Attorneys
National Economic Research Assoc.	158,033	158,033	Consultants
NUS Licensing	72,853	72,853	Licensing Information
Southern Nuclear	8,500	—	Consultants
State of Ohio	60,000	60,000	Building Permit
Winthrop, Stimson, Putnam & Roberts	68,775	68,775	Legal Consultants
General Physics Corporation	5,079	5,079	Consultants
Cleveland Electric Illuminating	4,078	4,078	Engineering
N.R.C.	62,500	62,500	Nuclear Regulatory Commission
Ohio Siting Commission	66,000	66,000	Siting Permit
S. M. Staller Corp.	36,262	36,262	Consultants
Ohio Edison Company	4,306,331	3,085,088	Eng. & Supv., A&G Costs, Other out of pocket Exp.
Total	63,662,311	30,856,062	

NOTE: Above costs represent total 100% project costs, Penn Power proportionate share is 6.28%.

Exhibit 2

Davis-Besse Units 2 and 3
Total Expenditures as at December 31, 1980

Vendor	Davis-Besse Unit 2	Davis-Besse Unit 3	Purpose
A. Bentley & Sons	8,573	8,573	Surveying and dozer work for drilling
Chicago Bridge & Iron	1,668,604	155,885	Containment vessel
Bechtel Power Corp.	16,847,052	16,837,183	Architect and engineering service
Toledo Edison Company	14,491,390	13,795,375	Support services construction
NUS Corporation	396,472	393,393	Technical services—licensing
Fuller, Henry, Hodge & Snyder	150,584	150,224	Legal services
Shaw, Pittman, Potts & Trowbridge	44,215	44,216	Legal consulting service
Woodward—Clyde	1,378,794	1,354,435	Geotechnical consulting service
Value Engineering	198,199	198,199	Develop nuclear QA. prog.
Duane & Kathleen Braugh	55,122	55,123	61 acres of land
Pickard-Lowe & Assoc.	11,419	11,419	Consulting service
Dames & Moore	72,961	72,962	Consulting service AEC questions
National Economic Research	18,918	18,919	Consulting licensing activity
Andrus Survey Co.	1,219	1,219	Survey Brough property
G. M. Barton Survey	7,673	—	Survey D/B 2 & 3
Maumee Valley Silkscreen	662	661	Screen print OPSC application
NUS Corporation	17,555	17,554	Assistance to obtain certificate
NUS Corporation	183,611	—	On-site meteorological system
Monarch Printing	14,609	14,609	Printing & binding service
Treasurer, State of Ohio	18,239	17,505	Sales Tax
Babcock & Wilcox	33,499,737	—	Nuclear steam supply system
Glenn Graffice	1,217	1,217	Core drilling of test holes
Aerial Surveys	1,250	1,250	Topographical mapping
Sussman Asbestos	15,000	—	Office & warehouse bldg.
United Engineers & Constructors	8,619,922	8,585,473	Constructors
Interpace	659,925	248,873	Circulating water pipe (concrete)
Can Tax c/o Meyers	30,817	30,817	Sewage treatment plant
Continental Boiler Works	304,733	304,733	Welded steel circ. water pipe
Arthur Andersen & Co.	158,602	158,602	Project management study

Vendor	Davis-Besse Unit 2	Davis-Besse Unit 3	Purpose
Richmond Engineering	7,836	7,836	Engineering—6 tanks
Hardy & Dischinger	11,288	—	Fire protection equipment
Science Applications	55,011	55,011	Quality assurance service
Energy Controls	5,018	—	Vertical duplex sump pump
Mr. Charles McLain	9,050	9,050	Management services
Vann Loon Industries	3,863	3,863	Fire hydrants & access.
Bingham—Willamette	10,549	10,549	Contaminant spray pump 7 meter
Richmond Engineering	29,971	29,971	Misc. nuclear tanks
Nooter Corporation	15,125	15,125	Stainless steel liner plates
HPD Incorporated	17,500	17,500	Fabricate degasifiers
Marsh & McLennan	6,285	6,285	Builders risk insurance
Quickborner Team, Inc.	7,700	—	Plan administration building
Ohio Citizens Trust Co.	7,938	7,938	Interest—advanced fund
Ohio Citizens Trust Co.	232,600	232,600	Lease—concrete batch plant
Hardy & Dischinger	28,847	28,847	Yard loop fire protection equipment
Toledo Building Service	9,488	9,487	Janitorial service
Xerox Corporation	2,192	2,192	Maintenance 3 machines
Lee Storage Company	2,258	2,258	Move to COB
Wm. Ferrel, Inc.	14,863	8,703	Site maintenance & misc. site work
Bradwell	19,653	19,372	Maintenance COB
Norfolk & Western	880	840	Freight—Interpace pipe.
Treasurer, State of Ohio	54,360	54,360	OPSC—application fee
Arthur Andersen	47,293	47,293	Audit
Atomic Energy Commission	62,500	62,500	Construction fee
Cleveland Electric Illuminating	239,129	239,128	Engineering support & legal charges
NUS Corporation	4,345	4,344	Tech. service—add D/B 2 & 3
Monarch Printing	29,658	29,657	Print maps & etc. OPSC
Ohio Dept. of Transportation	1,000	—	Maintenance of traffic light
Gould Pumps	15,919	15,919	Cooling Water Pumps
Pressure Products	5,920	5,920	Waste Gas Compressors
Struthers—Wells	4,553	4,553	Heat Exchangers
Atlas Industrial	5,452	5,452	Borated Water Heaters and Coolers
Worthington Standard	13,490	13,490	Misc. Pumps

Exhibit 2

Davis-Besse Units 2 and 3
Total Expenditures as at
December 31, 1980

Vendor	Davis-Besse Unit 2	Davis-Besse Unit 3	Purpose
Salvage	(111,650)	(111,650)	
Other misc. vendors under $1,000 ea.	3,035	2,957	
Total Joint Project Cost	79,749,993	43,319,769	
Less Common & Shared Facilities in Service	10,999,635	10,738,768	
Termination Costs	68,750,358	32,581,001	

NOTE: Above costs represent total 100% project costs, Penn Power proportionate share is 6.28%.

Exhibit 3

DIRECT COSTS
January 1, 1981 through August 31, 1983

A. ERIE UNITS 1 AND 2	
Babcock & Wilcox Settlement (1)	$ 502,400
Townsend and Bottum, Inc., Charge (2)	62,800
Babcock & Wilcox (Storage of reactor coolant pump motors)	10,550
345 kV line costs (engineering & siting fees)	82,536
Miscellaneous	7,148
B. DAVIS-BESSE UNITS 2 AND 3	
Babcock & Wilcox Settlement (3)	910,600
Chicago Bridge & Iron Settlement (4)	47,100
Sale of tubing (Credit 7/83)	(32,485)
Sale of Common Facilities to Toledo Edison Co.	(5,508)
Miscellaneous Charges and Credits	(8,263)
TOTAL	$1,576,878

(1) See Attached Exhibit 4
(2) See Attached Exhibit 5
(3) See Attached Exhibit 6
(4) See Attached Exhibit 7

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners:

Raymond J. O'Connor, Chairman;
Georgiana Sheldon, J. David Hughes,
A. G. Sousa and Oliver G. Richard III.

Pennsylvania Power Company	**Docket No. ER81-779-005 (Phase I)**

OPINION NO. 211

OPINION AND ORDER AFFIRMING AND MODIFYING INITIAL DECISION

(Issued March 22, 1984)

This opinion affirms on all but one issue an initial decision issued in the above docket on June 20, 1983. The decision is modified only to the extent that we find a 16.37 percent rate of return on common equity to be appropriate.

The proceeding involves a two-level rate increase to five wholesale, full requirements customers of Pennsylvania Power Company (Penn Power or Company). The affected customers are the Boroughs of Ellwood City, Grove City, New Wilmington, Wampum, and Zelienople, Pennsylvania (Boroughs). The Company's proposed Rate Level A, which became effective subject to refund on January 24, 1982, would increase revenues by approximately $1.67 million. The proposed Rate Level B, which became effective subject to refund from the date of the initial decision, would produce a further rate increase of approximately $650,000. The rates are open-ended.

The initial decision addresses all issues in Phase I of the proceeding except those relating to the Company's coal purchases from the Quarto Mining Company. Price squeeze issues will be resolved in Phase II. The Boroughs, except for Wampum, have excepted to the initial decision on virtually all issues.

Initially, the Boroughs allege that no increase over the Level A rate can take place prior to a decision on the Quarto coal pricing issue and evaluation of nuclear abandonment costs. These same arguments were also made in the Boroughs' September 6, 1983 objections to a compliance filing made by the Company on August 3, 1983. On January 13, 1984, we issued an order in this docket rejecting the Boroughs' arguments and accepting Penn Power's compliance rates, subject to refund. In accordance with that order, the Level B rates will be effective the date of the initial decision.

Other exceptions by the Boroughs are addressed separately below. To the extent any exceptions are not addressed in this opinion, we affirm and adopt the initial decision on those issues.

Rate of Return

* * *

Capital Structure

* * *

Revenue Credits

* * *

69 Kv Discount

* * *

Cancellation Costs of Nuclear Plants

On January 23, 1980, Penn Power and the other members of the Central Area Power Coordination Group (CAPCO) terminated construction of four jointly owned nuclear units. The Company proposed in this proceeding to recoup its share of the cancellation losses from the ratepayers. The judge ruled that Penn Power could recover its investment over a 10-year period, and directed that it comply with the variable amortization and reporting procedures approved in *Northern States Power Co.*, Opinion No. 134, 17 FERC ¶61,196 (1981). He further determined that the losses may include equity AFUDC and that amortization should begin with the effective date of the rates rather than the actual date of the loss.

The Boroughs have five major exceptions to the judge's decision: (1) The Company failed to prove the prudency of settlement expenditures associated with the loss, as required by *Northern States*, Opinion No. 134, *supra*. (2) The judge erred in allowing amortization to begin on January 24, 1982, rather than recognizing the actual date of the loss, January 20, 1980. (3) Collection of the cancellation charges in wholesale rates is discriminatory and anti-competitive. (4) To the extent cancellation losses are allowed, the common equity portion of AFUDC should be removed. (5) The amortization period should be 30 rather than 10 years since the useful life of the facilities would have been 10 years had they been completed.

For the reasons stated below, we reject the Boroughs' exceptions and affirm the initial decision.

The Commission's policy has been to allow utilities to recover the costs associated with cancelled plant where

investment in the plant was prudent and the cancellation costs are reasonable.[26] No participant in this case challenged the prudence of the Company's decision to cancel the plants, or the amount of loss claimed.

The Boroughs' claim that the Company failed to prove the prudency of its settlement expenditures is misplaced. Settlement expenditures are costs incurred when the utility has to cancel contracts associated with cancelled plants. According to the Boroughs, *Northern States* requires that all vendor settlements be made and determined prudent before *any* cancellation costs can be recovered, and the Company should not be allowed to increase its rates above Level A until the *Northern States* procedures have been fully satisfied. This is not what *Northern States* requires. In that case we tentatively allowed the utility to include estimated abandonment costs in its cost of service, subject to adjustment as the vendor claims were settled and subject to the filing of quarterly reports on the vendor settlements. The procedure set forth in that case, and followed by the judge here, requires that the initial estimated cancellation costs be adjusted to ultimately reflect the actual costs incurred. It did not preclude recovery of any costs prior to a determination of the prudency of the vendor settlements. The judge properly followed the *Northern States* approach.

The second matter raised by the Boroughs is whether amortization of the cancellation losses should begin in January 1980 instead of January 24, 1982. The Bor-

[26] *New England Power Co.*, Opinion No. 49, 8 FERC ¶61,054 (1979), *aff'd sub nom. NEPCO Municipal Rate Committee* v. *F.E.R.C.*, 668 F.2d 1327 (D.C. Cir. 1981), *cert. denied*, 457 U.S. 1117 (1982); *Northern States Power Co.*, Opinion No. 134, 17 FERC ¶61,196 (1981), *aff'd sub nom. South Dakota PUC* v. *F.E.R.C.*, No. 82-1276 (8th Cir. Oct. 19, 1982).

oughs argue that use of the 1982 date is contrary to the Uniform System of Accounts and results in retroactive ratemaking. We find no merit to either argument. First, we are dealing here with proper ratemaking treatment of the cancellation losses, not proper accounting treatment.[27] Second, the Boroughs apparently misunderstand the meaning of retroactive ratemaking. The rule against retroactive ratemaking is that a utility may not set rates to recoup past losses, nor may a regulatory commission prescribe rates on that principle.[28] There has been no attempt to substitute new rates for the rates in effect prior to the January 24, 1982 effective date of the rates in this docket. The Company has sought to include the costs in its rates in the first rate increase filing made after the loss occurred. We affirm the January 24, 1982 date.

The Boroughs also object to the judge's failure to address their contention that inclusion of the cancellation costs in wholesale rates is discriminatory and anti-competitive. They claim they make up only three percent of Penn Power's total sales, yet the Company has been collecting loss charges only from those minority sales. No such costs were charged in the firm power transaction with the parent, Ohio Edison, or in any prior retail cases.

The Boroughs' discrimination arguments tend to ignore the fact that the issue here is whether the cancella-

[27] In any event, by letter dated June 27, 1980, the Commission's Chief Accountant gave Penn Power's parent, Ohio Edison, permission to amortize the losses for both companies over a 10-year period, "beginning with the date rates in your next rate filing which provides for recovery of the property loss become effective."

[28] *Nader* v. *F.C.C.*, 520 F.2d 182, 202 (D.C. Cir. 1975); *City of Piqua* v. *F.E.R.C.*, 610 F.2d 950, 954 (D.C. Cir. 1979); *Public Service Co. of N.H.* v. *F.E.R.C.*, 600 F.2d 944, 957 (D.C. Cir. 1979).

tion losses are just and reasonable costs which should be borne in part by the wholesale customers. They have not shown that the losses are unreasonable or that they are not a legitimate cost to be included in rates. The fact that the Company has not been collecting cancellation costs from the retail customers does not automatically make their inclusion in this proceeding discriminatory. Any substantive evidence to show that the loss charges are discriminatory or anti-competitive should be presented in Phase II.

The Boroughs next argue that the common equity portion of AFUDC should be removed from the costs allowed. The judge rejected their arguments, relying on our decision on the same issue in *Northern States*. We affirm his ruling. In *Northern States*, we determined that the carrying cost on investment is as much a legitimate expense of the project as are the more tangible costs such as parts and materials. We concluded that if the shareholder were required to shoulder part of the AFUDC, the risk of investing in electric utilities would be increased and the cost of capital would increase to the extent necessary to compensate for the additional risk.

On exceptions, the Boroughs contend the instant case is distinguishable from *Northern States* because removal of equity AFUDC in this case would not increase the risk of investment in penn Power. The evidence which purportedly supports their position however, consists of the unsupported opinions of a rate of return witness.[29] They have presented no substantive evidence that would cause us to depart from our findings in *Northern States*. Furthermore, they have failed to address our

[29] Tr. 682-685.

conclusion in that case that it would be improper to single out one component of construction cost (equity AFUDC) for disallowance from amortization, particularly since investors and other readers of a utility's financial statements rely on reported earnings and the assurance that capitalized amounts represent valid assets. We see no reason not to apply the rationale of *Northern States* to this case.

Lastly, the Boroughs seek a 30-year amortization period rather than a 10-year period because 30 years is the expected useful life of the cancelled plants. This "useful life" standard was rejected by us in both *New England Power Co.* and *Northern States, supra.* In both cases we balanced the interests of investors and ratepayers and found the impact on the cost of service as one of the most important factors to be considered. In this case the use of a 10-year period results in an annual allocation of approximately $31,600 to the wholesale customers, or approximately 0.6 percent of the cost of service[30]—a figure comparable to those in the above-mentioned cases. The judge's decision is consistent with precedent and is affirmed.

Unused Investment Tax Credits

* * *

Compliance

Attached as Appendix A is the Commission's required compliance in accordance with the terms of this opinion and order. Rate Level A is found acceptable. Rate Level B is found excessive, thus requiring refunds. However, we note that both Rate Levels A and B are

[30]Exh. 54, p. 2.

subject to further refunds pending the outcome of the Phase II price squeeze proceeding and resolution of the Quarto coal issue.

The Commission orders:

(A) The initial decision issued in this proceeding on June 20, 1983 is affirmed and adopted to the extent not modified herein.

(B) Within 75 days of the issuance of this order, Penn Power shall file revised tariff sheets reflecting the cost of service in Appendix A. However, if an application for rehearing is pending at the end of the 75-day period, such filing shall be made within 30 days from the date the application is disposed of by the Commission.

(C) Within 30 days of the Commission's approval of revised tariff sheets, Penn Power shall refund to its customers, with interest, any amounts collected in excess of those allowed herein.

(D) In accordance with the Commission's January 21, 1982 order setting this case for hearing, any party desiring to pursue the price squeeze issue in this proceeding shall notify the Commission within 75 days following the date of issuance of this opinion. However, if an application for rehearing is pending at the close of the 75-day period, the above-mentioned notification shall be made within 30 days following the date the application for rehearing is disposed of by the Commission.

(E) Within 30 days of the issuance of this opinion, Penn Power shall file with the Commission and the Intervenors a detailed explanation of the $16,031,107 claimed in the proceeding as the final amount related to all vendor settlements. Thereafter, if the above amount is not the final vendor settlements amount, the Company must submit quarterly reports documenting vendor settlements

until all claims have been settled. Any party who believes that the vendor claims have been imprudently settled will have 30 days after the Company's filing to petition the Commission to conduct a further inquiry into the matter. This requirement does not affect the effectiveness of the Level B rates.

By the Commission. Commissioner Sousa dissented in part with a separate statement attached.

(SEAL)

/s/ LOIS D. CASHELL

Lois D. Cashell,
Acting Secretary.

(Issued March 22, 1984)

SOUSA, A. G., COMMISSIONER, *dissenting in part:*

I must dissent from the majority's use of post-record market data to reduce Penn Power's allowed rate of return on common equity from the presiding judge's recommended 17.25% to 16.37%.

* * *

/s/ A. G. SOUSA

A. G. Sousa
Commissioner

APPENDIX K

Jersey Central Power & Light Co. v. FERC

JERSEY CENTRAL POWER & LIGHT COMPANY,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent,

Allegheny Electric Cooperative, Inc., et al., Intervenors.

No. 82-2004.

United States Court of Appeals,
District of Columbia Circuit.

Argued Jan. 30, 1986.

Decided Feb. 3, 1987.

As Amended Feb. 3, 1987.

[Summary by West Publishing Co.]

Electric utility petitioned for review of order of the Federal Energy Regulatory Commission modifying utility's rate schedule to exclude from rate base utility's investment in cancelled nuclear power plant and denying utility's petition for rehearing. The Court of Appeals, 730 F.2d 816 affirmed. On petition for rehearing, the Court of Appeals, 768 F.2d 1500, remanded. Petition to rehear the case en banc was granted, 776 F.2d 364. The Court of Appeals, Bork, Circuit Judge, held that utility's allegations raised issue of whether rates ordered by Federal Energy Regulatory Commission were "just and reasonable," entitling utility to evidentiary hearing.

Vacated and remanded.

Starr, Circuit Judge, filed concurring opinion.

Mikva, Circuit Judge, filed dissenting opinion in which Wald, Chief Judge, and Spottswood W. Robinson, III and Harry T. Edwards, Circuit Judges, joined.

BORK, Circuit Judge:

Jersey Central Power and Light Company petitions for review of Federal Energy Regulatory Commission orders modifying the electric utility's proposed rate schedules and requiring the company to file reduced rates. Jersey Central charges that it alleged facts which, if proven, show that the reduced rates are confiscatory and violate its statutory and constitutional rights as defined by the Supreme Court in *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1944). Though it is probable that the facts alleged, if true, would establish an invasion of the company's rights, the Commission refused the company a hearing and reduced its rates summarily.

Throughout the extensive proceedings before both the Commission and this court, the Commission has steadfastly maintained that its summary dismissal of Jersey Central's filing was justified by prior Commission precedent. Faced with the claim that the rate order was inconsistent with the Commission's statutory responsibility to provide just and reasonable rates and with the constitutional prohibition against uncompensated takings, the Commission briefs advance a legal theory which, if adopted by this court, would immunize virtually all rate orders from this type of challenge. The Commission's theory flies in the face of every Supreme Court decision that addresses this subject, and we are bound to reject it.

The intervenors, customers of Jersey Central, advance a quite different rationale for affirming the Commission. They attempt to justify the denial of a hearing with the argument that Jersey Central followed the wrong procedures and therefore lost the opportunity to

have its substantive claims heard. Thus, it is said, it was the company's fault, not the Commission's, that no hearing was held.

That reasoning provides no basis for affirming the Commission. It fails to come to grips with the character of the Commission decision we review. That decision does not rest on adjective law. The Commission in fact reached and peremptorily decided the merits of the utility's claim. The substantive *Hope Natural Gas* issue is, therefore, squarely before us and cannot be avoided by faulting the utility for employing defective tactics. The Commission ruled that Jersey Central's allegations and proffered testimony would not support a higher rate. That substantive ruling means that a hearing would have been pointless. The ruling is inconsistent with *Hope* as well as with other controlling precedent of the Supreme Court and of this court. Reversal and remand for a hearing are thus required.

Though the fact that the Commission reached the merits renders irrelevant the intervenors' procedural rationale, it should be noted that if procedural fault is to be assigned, it should be laid at the Commission's doorstep. In dealing with Jersey Central's rate filings, the Commission applied unclear rules arbitrarily. Moreover, the Commission made plain, contrary to the intervenors' rationale, that no procedure could have been followed that would have guaranteed the hearing sought. The explanation for what has taken place in these convoluted proceedings appears to be less that Jersey Central followed incorrect procedures than that the Commission resists "end result" examination at the agency level, and is deeply antagonistic to court review of ratemaking under the guidelines laid down by *Hope*.

The decision of the Commission is vacated and the case remanded for a hearing at which Jersey Central may finally have its claim addressed.

I.

This case already prompted two opinions from this court, both of which we have since vacated. *See Jersey Central Power & Light Co. v. FERC*, 730 F.2d 816 (D.C. Cir.1984) ("*Jersey Central I*"); *Jersey Central Power & Light Co. v. FERC*, 768 F.2d 1500 (D.C.Cir.1985) ("*Jersey Central II*"). The case has now been reheard *en banc*, and the court has had the benefit of supplemental briefing and oral argument from the parties, the intervenors, and several *amici curiae*.[1]

On March 31, 1982, Jersey Central filed proposed rate schedules with the Commission for wholesale service to six customers. Jersey Central divided its filing into two separate rate increases designated Phase A and Phase B. Phase A has gone into effect, and Phase B is the subject of this litigation.

At issue is the utility's proposed treatment of the $397 million investment lost when it suspended construction of its nuclear generating station at Forked River, New Jersey. The Forked River project was initiated about a decade and a half ago, when federal and state agencies were encouraging utilities to commit substantial amounts of capital to nuclear generating plants

[1]Supplemental briefs were filed by petitioner Jersey Central Power and Light Company, by respondent FERC, by intervenors Allegheny Electric Cooperative, Inc. and the New Jersey Boroughs of Butler, Lavallette, Pemberton, and Seaside Heights, and by four amici: the Pennsylvania Public Utility Commission, the National Association of Regulatory Commissioners ("NARUC"), the Pennsylvania Office of Consumer Advocate, and the National Association of State Utility Consumer Advocates. Oral argument was presented by the parties and intervenors, and by NARUC.

that required lead times of eight to twelve years. The consensus prediction was of substantial and steady increases in the demand for electricity and substantial and continued increases in the price of oil due to the operation of an international oil cartel. Regulated public utilities are under statutory obligations to plan and build the facilities necessary to meet the projected needs of their customers. *See, e.g.*, 16 U.S.C. § 824a(g) (1982); N.J.Stat.Ann. 48.3-3 (West 1969). If firms and households were not to face catastrophic energy prices in the future, it was thought essential that nuclear generating plants be built. All parties agree that Jersey Central's investment at Forked River was prudent when made.

The forecasts of both demand and supply proved wrong. Due to conservation, demand did not rise nearly as much as expected, and, with the collapse of the international cartel, the oil market has experienced a worldwide glut and a dramatic decline in prices. Furthermore, the protracted litigation and political controversy which attended the construction of nuclear power projects resulted in extensive delays and dramatic increases in their ultimate cost. Thus, many investments which were prudent, indeed considered essential, when made, have now by necessity been cancelled. Forked River was one, and in 1980 Jersey Central abandoned it, having concluded that it must devote whatever resources it had available to . . . less capital intensive and more politically acceptable alternatives." Testimony of Dennis Baldassari at 7, Joint Appendix ("J.A.") at 34.

Jersey Central sought to recover the cost of the Forked River investment by amortizing the $397 million over a fifteen-year period, a proposal to which the Commission agreed. Jersey Central also requested, how-

ever, that the unamortized portions be included in the rate base, with a rate of return sufficient to cover the carrying charges on the debt and the preferred stock portions of that unamortized investment. Jersey Central expressly did *not* seek a return on that portion of the unamortized investment allocable to its common equity investors.

In support of its proposal, Jersey Central submitted to the Commission the testimony of Dennis Baldassari, its Vice-President and Treasurer. J.A. at 28-39. Baldassari sought to demonstrate that the financial problems faced by Jersey Central made necessary earnings and revenues at the level contemplated by its filing. Baldassari characterized the utility's financial condition as "delicate." Testimony of Dennis Baldassari at 9, J.A. at 36. Jersey Central was wholly dependent for short-term credit, he explained, on a Revolving Credit Agreement which was subject to termination at any time. The only long-term securities it was able to issue were themselves subject to mandatory repurchase by the utility should the short-term credit then available to it be for any reason terminated. Jersey Central's credit standing was, therefore, predictably low. Standard & Poor's Corporation rated its senior debt securities "BB-", *i.e.*, "regarded, on-balance, as predominantly speculative with respect to capacity to pay interest and repay principal in accordance with the terms of the obligation." Moody's Investors Service had also downgraded Jersey Central's rating, classifying its securities "Ba", *i.e.*, "judged to have speculative elements; their future cannot be considered as well-assured. Often the protection of interest and principal payments may be very moderate, and thereby not well safeguarded during both good and bad times over the future. Uncertainty of position characterizes bonds in this class." *Id.* at 4, J.A. at 31.

Jersey Central's lack of access to long-term capital, and the precariousness of its short-term credit, placed it in serious financial difficulty. Baldassari described the rate increase requested as "the minimum amount necessary to restore the financial integrity of the Company thereby providing the means by which Jersey Central will be able to meet its obligation to provide safe and dependable service in the future." Testimony of Dennis Baldassari at 12, J.A. at 39. The focus of his testimony, therefore, was on the overall rate necessary to preserve his company's access to capital markets and its financial integrity.

The Commission responded by issuing an order summarily excluding the unamortized portion of the investment from the rate base. Order Accepting for Filing and Suspending Revised Rates, Granting Interventions, Granting in Part and Denying in Part Motions for Summary Disposition, and Establishing Procedures, 19 F.E.R.C. (CCH) ¶ 61,208 (May 28, 1982). No discussion or analysis accompanied this portion of the order. The Commission simply noted that "consistent with Commission precedent ... unamortized investment in cancelled plants must be excluded from rate base." *Id.* at 61,403 (footnote omitted). The precedent to which the Commission referred was *New England Power Co.*, 8 F.E.R.C. (CCH) ¶ 61,054 (July 19, 1979), *aff'd sub nom. NEPCO Municipal Rate Comm. v. FERC*, 668 F.2d 1327 (D.C.Cir. 1981), *cert. denied sub nom. New England Power Co. v. FERC*, 457 U.S. 1117, 102 S.Ct. 2928, 73 L.Ed.2d 1329 (1982) ("*NEPCO*"). The utility in *NEPCO* had been permitted to recover the costs of its failed investment by amortizing it over a five-year period, but was denied its request to include the unamortized portion in the rate base.

NEPCO's proposal differed from that later made by Jersey Central in several respects. NEPCO's requested amortization period was only one-third as long as that proposed by Jersey Central; NEPCO proposed a full return on the unamortized portion of the investment, including that allocable to common equity, as opposed to simply a return sufficient to cover the carrying charges on debt and preferred stock portions; and NEPCO never alleged that its financial integrity and its ability to maintain access to capital markets depended upon the rate it was requesting.

Upon receiving the Commission's order, Jersey Central filed an Application for Rehearing, J.A. at 99-135, seeking a full evidentiary hearing in which its proposal, and the factual foundation supporting it, could be examined. Jersey Central argued that NEPCO did not control because the allocation of risk in Jersey Central's proposal was different from, and more favorable to consumers than, the allocation proposed and rejected in *NEPCO*. Jersey Central argued as well that more recent Commission precedent on the treatment of abandoned investments in gas pipeline facilities provided support for its proposal. Finally, Jersey Central advanced a position that became a central issue briefed and argued in this appeal. It is axiomatic that the end result of Commission rate orders must be "just and reasonable" to both consumers and investors, and that, in achieving this balance, the Commission must consider the impact of its rate orders on the financial integrity of the utility. Jersey Central argued that, for these reasons, the Commission may not *summarily* exclude an investment from the rate base when the utility has alleged that its ability to attract capital will be seriously jeopardized as a result. Jersey Central contended that it was entitled to a

hearing at which it would have the opportunity to prove its allegations and demonstrate that the end result of the Commission's orders violated the applicable statutory and constitutional standards, a hearing that would create a record through which the Commission's effort to balance the relevant consumer and investor interests would be subject to judicial review.

Alternatively, since Jersey Central's concern was with the end result of the rate order, it requested an evidentiary hearing at which it could justify a rate of return higher than that included in its original filing to compensate for the rate base limitation that the agency claimed was necessitated by Commission precedent. The rate allowed a utility is the sum of (1) its cost of service, and (2) its rate base multiplied by its rate of return. Since the Commission's order had excluded Forked River from the rate base, Jersey Central suggested that the necessary rate could be achieved through raising the rate of return.

The Commission again refused to grant Jersey Central a hearing. The Commission explained, somewhat cryptically:

> We recognize that, in accord with *Hope Natural Gas Co., supra*, it is the "end result" which must be just and reasonable. Nonetheless, the reasonableness of that end result cannot be evaluated without regard to the individual components which comprise a rate. . . .
>
> . . . JCP & L's argument that our decision to exclude cancelled project costs from rate base is not mandated by Commission precedent is . . . without merit. Furthermore, the argument that a hearing is required in order to implement this policy deter-

> mination, is erroneous. Since Opinion No. 49, the Commission has consistently resolved this issue through summary disposition.

Order Granting in Part and Denying in Part Application for Rehearing, 20 F.E.R.C. (CCH) ¶ 61,083, at 61,181-82 (July 23, 1982) (footnote omitted). The Commission then denied the request for a hearing on the alternative proposal of a higher rate of return, on the grounds that modifying the filing at that stage would unfairly present the Commission and the intervenors with a "moving target," and, further, that Jersey Central's "case-in-chief contain[ed] no testimony or exhibits which would support a higher return." *Id.* at 61,182. When the Commission denied Jersey Central's Application for Rehearing and Reconsideration as well, this appeal was filed.

A unanimous panel of this court affirmed the Commission. The utility claimed that the Commission's orders were not the product of reasoned decisionmaking because they were inconsistent with the gas pipeline cases and because application of the *NEPCO* precedent to the facts of this case was irrational. The utility also claimed that it was entitled to an evidentiary hearing in which it could justify its alternative request for a higher rate of return. All these claims were rejected. We then turned to Jersey Central's contention that *Hope Natural Gas* required that there be a hearing to ensure that the "end result" of the rate order was "just and reasonable." The path we took in resolving this issue was later challenged by *both* parties:

> Jersey Central argues that, as a result of the Commission's orders, its rate of return overall will be too low to be characterized as "just and reasonable." In denying rehearing, however, the Commission responded that "the reasonableness of that end result cannot be evaluated without regard to the individual components which comprise a rate." Commission Order at 61,181. This is a rather terse explanation and we wish that in the future the Commission would share its undoubted expertise with us a bit more generously. We understand the Commission to be saying, however, that the end result is to be judged by the rate of return allowed on items for which a rate of return is allowable, the Forked River expenditure is not such an item, and the rates are just and reasonable as to those cost items that are properly in the rate base. The dispute thus boils down to the question of whether the end result test is to be applied to a utility overall or only to those assets which valid Commission rules permit to be included in the rate base.

Jersey Central I, 730 F.2d at 823. Having thus defined the dispute, we accepted what we thought to be the Commission's position and concluded that the end result applied only "to those assets which valid Commission rules permit to be included in the rate base."

In its petition for rehearing before this court, Jersey Central stated that we had mischaracterized the "end result" test by focusing not on the result of the rate order but on the determination of the rate base, which is only one component of that order. We asked the Commission for a response, and it provided one we found incomprehensible:

> In the Commission's view the Court characterized the "end result" test more narrowly than the Commission would have; and, accordingly, it believes it would be appropriate for the Court to amend this aspect of its opinion. Nevertheless, the Commission believes the Court properly affirmed the Commission's orders in this case, since it is well-settled that

> the end-result test only has application to items which are legitimately included in the rate base as "used and useful."

Response of Respondent FERC to Petition for Rehearing at 2. Since this response seemed both to reject and accept our reasoning, the Commission had still not offered us any guidance as to how it construed *Hope*'s "end result" test. Dissatisfied, the court entered a further order which read, in pertinent part:

> [W]e direct the Commission to elaborate on its cryptic comment that, "[i]n the Commission's view the Court characterized the 'end result' test more narrowly than the Commission would have; and, accordingly, it believes it would be appropriate for the Court to amend this aspect of its opinion." Response at 2. This statement is unhelpful. The Commission should explain how and why it believes that the opinion should be amended. We therefore order that the Commission provide further explanation of its position in the brief we have today directed it to file. Throughout these proceedings the court has found the Commission's submissions singularly terse and uninformative.

Order of July 16, 1984. The Commission filed a second response in which it now agreed with Jersey Central that the end result test does not only apply to those assets which valid Commission rules permit to be included in the rate base. Brief for Respondent FERC in Response to the Court's Order of July 16, 1984, at 4. The second response described the "end result" test as "simply an expression for broadly gauging whether, based on all the facts before it, the Commission's orders in a particular case produce a reasonable result." *Id.* at 5. The Commission nevertheless suggested that the end result test was not a standard under which a court was

authorized to set aside an unjust end result, but rather "was designed to accord the Commission broad discretion over all aspects of rate-making methodology." *Id.* at 6.

This response meant that the "end result" test applied to the overall situation produced by the Commission's action but that the Commission not only refused to hold a hearing on that subject but also believed its refusal to be virtually immune from judicial review. Finding no support for the arresting proposition that the Commission was immune from challenges in court over rate orders alleged to violate statutory and constitutional guarantees explicated by the Supreme Court, the panel—now divided—vacated its prior decision. Jersey Central had alleged that "for four years [it] had been unable to pay any dividends on its common stock"; that in part as a consequence of the Commission's orders it had been "repeatedly on the edge of being forced into bankruptcy"; and that since 1979 it

> has had no access to the long-term capital markets and has been wholly dependent upon a short-term revolving credit agreement which was subject to termination at a moment's notice. [The company] has been allowed sufficient cash flow to enable [it] to avoid bankruptcy (but not to provide earnings [sufficient] to enable [it] to attract capital or maintain credit).

Petition for Rehearing and Suggestion for Hearing En Banc at 14. Since the Commission had never held a hearing, there was no way of knowing whether these allegations were true, but we noted that if they were, it "would suggest that FERC's actions were illegal under the end result test of *Hope Natural Gas*," *Jersey Central II*, 768 F.2d at 1502, because the Commission might well

have failed to achieve "a reasonable balancing of investor and consumer interests in keeping with the requirement that rates be 'reasonable, just, and non-discriminatory.'" *Id.* at 1503. We therefore remanded the case to the Commission for a hearing at which Jersey Central would have the opportunity to present its evidence on the inadequacy of the rates allowed it. *Jersey Central II* was vacated when a majority of the court voted to rehear this case *en banc*.

II.

A.

The parties offer radically differing views of the Commission's obligations under *Hope Natural Gas*, a decision in which the Supreme Court set forth the applicable standard of judicial review when rates ordered by an agency are challenged in court as failing to meet the statutory requirement that they be "just and reasonable." The *Hope Court* was construing the Natural Gas Act of 1938, §§ 4(a), 5(a), 52 Stat. 821, 822, 823–24 (codified as amended at 15 U.S.C. §§ 717c(a), 717d(a) (1982)). The Federal Power Act, 16 U.S.C. § 824d(a) (1982), the source of the claim in this case, also requires that rates be "just and reasonable," and courts rely interchangeably on cases construing each of these Acts when interpreting the other. *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577 n. 7, 101 S.Ct. 2925, 2930 n. 7, 69 L.Ed.2d 856 (1981). Since the Court had previously indicated that "the Congressional standard prescribed by this statute coincides with that of the Constitution," *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 586, 62 S.Ct. 736, 743, 86 L.Ed. 1037 (1942), the *Hope* test defines the point at which a rate becomes unconstitutionally confiscatory as well.

In these proceedings the Commission itself has never stated what the "end result" test of *Hope Natural Gas* requires of it or of a reviewing court. In *Jersey Central I* and *II*, the Commission's appellate counsel offered us only the vague statements of the Commission's duties already quoted. As to the reviewing court's power under *Hope*, counsel told the panel in those proceedings essentially that the reviewing court had little, if any, function to perform. However, at oral argument before the court *en banc*, counsel finally advanced the novel proposition that the "end result" test empowers a court to set aside a rate order on the utility's petition only if the order would put the utility into bankruptcy. In order to show how dramatically at odds with the law that position is, we review the history of the doctrine at issue.

Hope Natural Gas reaffirmed a doctrinal shift, begun in *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 62 S.Ct. 736, 86 L.Ed. 1037 (1942), away from the more exacting and detailed standard of judicial review exemplified by *Smyth v. Ames*, 169 U.S. 466, 185 S.Ct. 418, 42 L.Ed. 819 (1898). Under *Smyth v. Ames*, courts had meticulously scrutinized rate orders to ensure that investors received the "fair value" of the property dedicated to public use. The "fair value" standard required courts to estimate the current market value of the property, and rates that provided anything less were deemed confiscatory. The governing theory required that consumers pay the market value of the property they were using because the property was regarded as having been taken. Recovery was therefore required only on property "used and useful" to the public, for property that was not being used could not be considered to have been taken. The Supreme Court cases of the 1940's eliminated the requirement that the market value of the property be

recovered, and regulated industries now collect rates calculated to generate a reasonable return on the *original cost* of the investment. The companies are still generally permitted to include in the rate base only property considered used and useful, but with the demise of "fair value," "used and useful" ceased to have any constitutional significance, and the Commission has at times departed from this standard. It is now simply one of several permissible tools of ratemaking, one that need not be, and is not, employed in every instance. *See Washington Gas Light Co. v. Baker*, 188 F.2d 11 (D.C.Cir.1950), *cert. denied*, 340 U.S. 952, 71 S.Ct. 571, 95 L.Ed. 686 (1951).

In setting aside the rigorous judicial scrutiny that had previously characterized review of rate orders, the Supreme Court substituted a far more deferential standard of review:

> Once a fair hearing has been given, proper findings made and other statutory requirements satisfied, the courts cannot intervene in the absence of a clear showing that the limits of due process have been overstepped. If the Commission's order, as applied to the facts before it and reviewed in its entirety, produces no arbitrary result, our inquiry is at an end.

FPC v. Natural Gas Pipeline Co., 315 U.S. at 586, 62 S. Ct. at 743. This new emphasis—on whether the order "viewed in its entirety" was the product of "proper findings" and was not "arbitrary"—evolved two years later into the "end result" test of *Hope Natural Gas*.

The *Hope* Court made clear that when a rate was claimed to be beyond "just and reasonable" boundaries, the focus of analysis was to be the end result of that order:

> [I]t is the result reached not the method employed which is controlling. . . . It is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end. . . . And he who would upset the rate order under the Act carries the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences.

320 U.S. at 602, 64 S.Ct. at 287 (citations omitted). Judging a rate order's consequences, the Court held, necessarily required a "balancing of the investor and the consumer interests." *Id* at 603, 645 S.Ct. at 288. The legitimate investor interest, which is the interest Jersey Central claims received inadequate attention in the proceedings before the Commission, was defined in *Hope* to include:

> the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock.

Id. The return, therefore, "should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital." *Id*.

Thus, in reviewing the rate order challenged in *Hope*, the Court considered the detailed findings made by the Commission concerning the financial condition of Hope Natural Gas Company. 320 U.S. at 603–05, 64 S.Ct. 288–89. After examining all of the relevant figures, the Commission had concluded that "[t]he company's efficient management, established markets, financial record, affiliations, and its prospective business place it

in a strong position to attract capital upon favorable terms when it is required." 44 P.U.R. (N.S.) 1, 33 (1942), *quoted in Hope*, 320 U.S. at 605, 64 S.Ct. at 289. After summarizing the Commission's findings and conclusions concerning the company's financial health, the Court held:

> In view of these various considerations we cannot say that an annual return of $2,191,314 is not "just and reasonable" within the meaning of the Act. Rates which enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed certainly cannot be condemned as invalid, even though they might produce only a meager return on the so-called "fair value" rate base.

320 U.S. at 605, 63 S.Ct. at 289.

In *Hope Natural Gas*, the rate was challenged as too low to account adequately for the legitimate interests of the investor. In *Washington Gas Light Co. v. Baker*, 188 F.2d 11 (D.C.Cir.1950), *cert. denied*, 340 U.S. 952, 71 S.Ct. 571, 95 L.Ed. 686 (1951), this court heard a challenge by a consumer who claimed that a rate increase approved by the Public Utilities Commission of the District of Columbia was too high to account adequately for the legitimate interests of the purchaser. The court applied the same analytical framework. Because the local public utilities commission was governed by the same standard as the Federal Power Commission, 188 F.2d at 14, Judge Bazelon's opinion examined the rate order under the rule set forth in *Hope Natural Gas*:

> So long as the public interest—i.e., that of investors and consumers—is safeguarded, it seems that the Commission may formulate its own standards. But

> there are limits inherent in the statutory mandate that rates be "reasonable, just, and nondiscriminatory." Among those limits are the minimal requirements for protection of investors outlined in the Hope case. And from the earliest cases, the end of public utility regulation has been recognized to be protection of consumers from exorbitant rates. Thus, there is a zone of reasonableness within which rates may properly fall. It is bounded at one end by the investor interest against confiscation and at the other by the consumer interest against exorbitant rates.

Id. at 15 (footnotes omitted). The court then set aside the rate order and remanded for further proceedings, on the ground that the Commission had not made sufficiently detailed findings of fact concerning the financial health of the company involved to support the reasonableness of its rate increase. "Despite the broad limits allowed the Commission, it remains imperative that its findings, under whatever formula adopted, be based upon substantial evidence in the record." *Id.* (footnote omitted). In that case, this court also indicated that the Commission was not obligated to exclude from the rate base all property not presently "used and useful," but was free to include prudent but cancelled investments. *Id.* at 19.

The Supreme Court has repeatedly reaffirmed the "end result" standard of *Hope Natural Gas*. *See, e.g., FPC v. Memphis Light, Gas & Water Division*, 411 U.S. 458, 474, 93 S.Ct. 1723, 1732, 36 L.Ed.2d 426 (1973) ("under *Hope Natural Gas* rates are 'just and reasonable' only if consumer interests are protected and if the financial health of the pipeline in our economic system remains strong"); *Colorado Interstate Gas Co. v. FPC*, 324 U.S. 581, 605, 65 S.Ct. 829, 840, 89 L.Ed. 1206 (1945) ("end

result" test "is not a standard so vague and devoid of meaning as to render judicial review a perfunctory process. It is a standard of finance resting on stubborn facts."). In *Permian Basin Area Rate Cases*, 390 U.S. 747, 88 S.Ct. 1344, 20 L.Ed.2d 312 (1968), the Court reviewed Commission orders setting area-wide rates for gas producers. Writing for the majority, Justice Harlan stated that a court reviewing rate orders must assure itself *both* that "each of the order's essential elements is supported by substantial evidence" *and* that "the order may reasonably be expected to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed, and yet provide appropriate protection to the relevant public interests, both existing and foreseeable." *Id.* at 792, 88 S.Ct. at 1373. In examining the end result of the rate order, he made clear, a court cannot affirm simply because each of the component decisions of that order, taken in isolation, was permissible; it must be the case "that they do not *together* produce arbitrary or unreasonable *consequences*." *Id.* at 800, 88 S.Ct. at 1377 (emphasis added). The Court in *Permian Basin* emphasized the necessity for Commission findings, the existence of which is a necessary predicate to judicial deference:

> The Court's responsibility is not to supplant the Commission's balance of these interests with one more nearly to its liking, but instead to assure itself that the Commission has given reasoned consideration to each of the pertinent factors. Judicial review of the Commission's orders will therefore function accurately and efficaciously only if the Commission indicates fully and carefully the methods by which, and the purposes for which, it has chosen to act, as well as its assessment of the consequences of its orders for the character and future development of the industry.

Id. at 792, 88 S.Ct. at 1373. And the Court once again reviewed the findings below and affirmed upon concluding that "the record before the Commission contained evidence sufficient to establish that these rates, as adjusted, will maintain the industry's credit and continue to attract capital." *Id.* at 812, 88 S.Ct. at 1383.

The teaching of these cases is straightforward. In reviewing a rate order courts must determine whether or not the end result of that order constitutes a reasonable balancing, based on factual findings, of the investor interest in maintaining financial integrity and access to capital markets and the consumer interest in being charged non-exploitative rates. Moreover, an order cannot be justified simply by a showing that each of the choices underlying it was reasonable; those choices must still add up to a reasonable result. Because the language of these cases is so plain, and the standard applied in each is the same, the preceding lengthy account may have appeared unduly repetitious. We have set out guiding precedent comprehensively, however, because the legal position taken by the Commission is at odds with every one of the requirements specified by these decisions.

In the face of a serious *Hope* challenge, the Commission made no findings, performed no balancing, offered no reasoned consideration of Jersey Central's allegations and proffered testimony, misstated the law by saying that the reasonableness of the end result cannot be evaluated without regard to the individual components that go into a rate, and, most recently, claimed that our reviewing function was ended if the rate order did not cast Jersey Central into bankruptcy.

This performance alone would justify reversal and a remand for a *Hope* hearing. But there was more: the Commission reached the merits and ruled that Jersey Central's allegations and testimony did not even raise a *Hope* issue. That was plain legal error.

B.

The allegations made by Jersey Central and the testimony it offered track the standards of *Hope* and *Permian Basin* exactly. The *Hope* Court stated that the return ought to be "sufficient to ensure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital," and that "it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock." 320 U.S. at 603, 64 S.Ct. at 288. *Permian Basin* reaffirmed that the reviewing court "must determine" whether the Commission's rate order may reasonably be expected to "maintain financial integrity" and "attract necessary capital." 390 U.S. at 792, 88 S.Ct. at 1373. Jersey Central alleged that it had paid no dividends on its common stock for four years and faced a further prolonged inability to pay such dividends. Baldassari's testimony explained that the company was unable to sell senior securities; that its only source of external capital was the Revolving Credit Agreement, which was subject to termination and which placed the outstanding bank loans the company was allowed to maintain below the level necessary for the upcoming year; that the need to pay interest on the company's debt and dividends on its preferred stock meant that common equity investors not only were earning a zero return, but were also forced to pay these interest costs

and dividends and that "continued confiscation of earnings from the common equity holder . . . will prolong the Company's inability to restore itself to a recognized level of credit worthiness"; that its "inability to realize fully its operating and capital costs so as to provide a fair rate of return on its invested capital has pushed its financial capability to the limits"; that "[a]dequate and prompt relief is necessary in order to maintain the past high quality of service"; and that the rate increase requested was "the minimum necessary to restore the financial integrity of the Company," Testimony of Dennis Baldassari at 5–6, 7, 10, 12, J.A. at 32–33, 34, 37, 39.

Inexplicably, the Commission ruled that Jersey Central's showing did not require a hearing because there were "no testimony or exhibits which would support a higher return." That ruling is flatly at odds with *Hope* and *Permian Basin*. Moreover, the Commission, having held no hearing, made no findings in support of its ruling and gave not a single reason for it. If the Commission and this court are bound by Supreme Court precedent, and we are, the Commission's case cannot stand.

C.

The Commission's apparent understanding of *Hope Natural Gas*, adopted by the dissent in *Jersey Central II*, is that the "end result" test acts only as a limitation of, and not at all as an authorization for, judicial review of rate orders. While the Commission "*may* also look to the criteria of *Hope* in determining whether its rate order is just and reasonable and *may* make pragmatic adjustments based on the perceived need to balance investor and consumer interests," Brief on Rehearing En Banc for Respondent FERC at 16 (emphasis added), it apparently considers a decision whether or not to do so

completely within its discretion. While the Commission's briefs have never explicitly claimed that courts are without authority to set aside rate orders deemed unjust and unreasonable in their consequences, or based upon insufficient findings, at no point in response to our numerous requests for briefing has the Commission indicated any role it believes proper for courts to play in reviewing the reasonableness of rate orders, save that of passively affirming them. Only at oral argument before the *en banc* court did Commission counsel concede that a court might set aside a rate order under *Hope* if the order would drive the company into bankruptcy, but that was the limit of the judicial power acknowledged.

The rationale for the Commission's position is difficult to discern, for, as noted in Section IIA, *supra*, that position can derive no support from the case law it purports to embody. The Commission, it appears, rests its theory in part on the fact that *Hope Natural Gas* represented a shift from strict to deferential judicial review, and, in the historical context in which it was decided, constituted a limitation on judicial review when compared to the standard it was replacing. But judicial review, while limited, was not eliminated, and the "end result" standard—like any standard of judicial review—confines judicial power not by eliminating review but by defining its reach. The delineation marked by the "end result" test thus simultaneously authorizes and constrains the courts that apply it. This is elementary jurisprudence.

The Commission also apparently locates support in language set forth in *Hope:* "If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end." *Hope*,

320 U.S. at 602, 64 S.Ct. at 288. *See also Jersey Central II*, 768 F.2d at 1511 (Mikva, J., dissenting). The Commission's litigating stance appears to interpret the Court's statement as if it were but one half of a larger proposition the Court meant to enunciate: judicial review is at an end if *either* the end result is just and reasonable *or* if it is not. Had he meant any such thing, Justice Douglas would simply have said that there is no more judicial review. Instead, he said that "he who would upset the rate order under the Act carries the heavy burden of making a convincing showing that it is invalid *because* it is unjust and unreasonable in its consequences." *Hope*, 320 U.S. at 602, 64 S.Ct. at 288 (emphasis added). He then went on to review the financial situation of the company, an exercise that would have been wholly superfluous if he had just announced the demise of judicial review. If the contrary view apparently embraced by the Commission were adopted, the end result standard would become "so vague and devoid of meaning as to render judicial review a perfunctory process." *Colorado Interstate Gas Co. v. FPC*, 324 U.S. 581, 605, 65 S.Ct. 829, 840, 89 L.Ed. 1206 (1945).

The Commission maintains that because excluding the unamortized portion of a cancelled plant investment from the rate base had previously been upheld as *permissible*, any rate order that rests on such a decision is unimpeachable. But that would turn our focus from the end result to the methodology, and evade the question whether the component decisions together produce just and reasonable consequences. We would be back with the assertion made in *Jersey Central I* that "the end result test is to be applied . . . only to those assets which valid Commission rules permit to be included in the rate base." 730 F.2d at 823. That statement was one

which neither party endorsed. It was incorrect. The fact that a particular ratemaking standard is generally permissible does not *per se* legitimate the end result of the rate orders it produces. Justice Harlan said just that in *Permian Basin*.

The position presented on behalf of the Commission, as we earlier observed, shifted to a minor extent during the course of these proceedings. At oral argument before the *en banc* court, counsel for the Commission indicated that the "end result" test *did* allow a court to set aside a rate order when the company would otherwise go bankrupt and the Commission had refused to take that into account. The source of this constricted standard is elusive, not to say invisible. *Hope Natural Gas* talks not of an interest in avoiding bankruptcy, but an interest in maintaining access to capital markets, the ability to pay dividends, and general financial integrity. While companies about to go bankrupt would certainly see such interests threatened, companies less imminently imperiled will sometimes be able to make that claim as well. Jersey Central alleges that it is such a company. The contention that no company that is not clearly headed for bankruptcy has a judicially enforceable right to have its financial status considered when its rates are determined must be rejected.

The dissent agrees with the Commission that *Hope* stands generally for a restriction on judicial review of a rate order, but erects its own constricted standard to determine when a company may obtain consideration of its financial status in review of a rate order. According to the dissent, Jersey Central could get a *Hope* hearing only by first making a sufficient showing on three critical points: that a "critical nexus" exists between the

rate order and the utility's financial plight; that the proposed rate filing would not lead to the exploitation of consumers; *and* that the overall return allowed on this project is not reasonable, and thus puts the company in need of protection at this phase of the ratemaking process. Dissent at 1205–09. It is remarkable that the dissent would affirm the Commission on a legal theory that neither the Commission nor its counsel ever advanced. The Commission offered no legal theory and counsel offered the unique bankruptcy-only theory. It is impossible to affirm on the basis of the Commission's silence or counsel's rationale. It should be equally impossible to suggest affirmance on the basis of a legal theory never surfaced until today. Indeed, the only correspondence between the three different postions taken by the Commission, its counsel, and the dissent, aside from their common hostility to *Hope*, is that none of them has any basis in any decision of any previous court. The dissent's new three-part barrier flatly ignores the factors that, according to the Supreme Court's controlling opinion in *Hope*, would necessitate an "end result" hearing into whether any revision of a rate order is necessary in light of a company's financial plight. Since Jersey Central submitted figures and testimony to support its claim that the rate order caused its financial distress, that its proposed rates would not exploit consumers, and that the overall rate of return allowed is not just and reasonable, one can only suppose that the dissent demands proof beyond doubt of its three criteria before the hearing is even held. That, most certainly, is not what *Hope* requires. The dissent thus joins the Commission in rejecting the Supreme Court's law.

In addition to prohibiting rates so low as to be confiscatory, the holding of *Hope Natural Gas* makes clear

that exploitative rates are illegal as well. If the inclusion of property not currently used and useful in the rate base automatically constituted exploitation of consumers, as one of the *amici* maintains, then the Commission would be justified in excluding such property summarily even in cases where the utility pleads acute financial distress. A regulated utility has no constitutional right to a profit, *see FPC v. Natural Gas Pipeline Co.*, 815 U.S. at 590, 62 S.Ct. at 745, and a company that is unable to survive without charging exploitative rates has no entitlement to such rates. *Market Street Ry. v. Railroad Comm'n of Cal.*, 324 U.S. 548, 65 S.Ct. 770, 89 L.Ed. 1171 (1945). But we have already held that including prudent investments in the rate base is not in and of itself exploitative, *Washington Gas Light Co. v. Baker*, and no party has denied that the Forked River investment was prudent. *Hope*, 320 U.S. at 603, 64 S.Ct. at 288.[2]

The central point, however, is this: it is impossible for us to say at this juncture whether including the unamortized portion of Forked River in the rate base would exploit consumers *in this case*, or whether its exclusion, *on the facts of this case*, constitutes confiscation, for no findings of fact have been made concerning the consequences of the rate order.[3] Nor, for the same reason, can we make a judgment about the higher rate of

[2]We have been reminded by the Commission and several of the *amici* that utilities ought not be immunized from the free play of market forces. Their application of this principle is peculiarly selective. Had the international oil cartel *not* collapsed, and had Forked River provided unusually inexpensive energy in a time of scarcity and high demand, Jersey Central would have received no windfall, but simply the standard return on its original investment. It seems odd, therefore, that it must bear so disproportionate a share of the loss when the prudent investment it made pursuant to its statutory obligations fails.

[3]We emphasize that we do not hold that a taking occurs every time a prudent investment is made but not included in the rate base. We thus explicitly reject the dissent's contention that under our holding "the investor

(footnote continued on next page)

return the utility sought as an alternative to inclusion in the rate base of its unamortized investment. Jersey Central has presented allegations which, if true, suggest that the rate order almost certainly does not meet the requirements of *Hope Natural Gas*, for the company has been shut off from long-term capital, is wholly dependent for short-term capital on a revolving credit arrangement that can be cancelled at any time, and has been unable to pay dividends for four years. In addition, Jersey Central points out that the rates proposed in its filing would remain lower than those of neighboring utilities, *see, e.g.*, Petition for Rehearing and Suggestion for Hearing En Banc at 8, which at least suggests, though it does not demonstrate, that the proposed rates would not exploit consumers. The Commission treated those allegations as irrelevant and hence has presented us with no basis on which to affirm its rate order. The necessary findings are simply not there for us to review. When the Commission conducts the requisite balancing of consumer and investor interests, based upon factual findings, that balancing will be judicially reviewable and will be affirmed if supported by substantial evidence. That is the point at which deference to agency expertise will be appropriate and necessary. But where, as here, the Commission has reached its determination by flatly refusing to consider a factor to which it is undeniably required to give some weight, its decision cannot stand. *Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402, 416, 91 S.Ct. 814, 823, 28 L.Ed.2d

is guaranteed a return on his investment, if prudent when made." Dissent at 1212. Whether or not such an approach might be desired as a matter of policy, our holding simply follows *Hope*. If a utility is in that state, the Commission must inquire whether a reasonable return—on investment, not on facilities—has been afforded to investors, taking into account whether any higher return would amount to exploitation of consumers. Under those circumstances, it may be permissible or even proper to grant the utility a greater return on its prudent investments than it otherwise would have received.

136 (1971).[4] The case should therefore be remanded to the Commission for a hearing at which the Commission can determine whether the rate order it issued constituted a reasonable balancing of the interests the Supreme Court has designated as relevant to the setting of a just and reasonable rate.[5]

III.

The intervenors, Allegheny Electric Cooperative and four boroughs of New Jersey, all purchasers of energy from Jersey Central, present an argument different

[4]This case thus raises completely different issues from those decided in *Pennsylvania Elec. Co. v. Pennsylvania Pub. Util. Comm'n*, 509 Pa. 324, 502 A.2d 130 (1985). The appeal from that decision was dismissed for want of a substantial federal question. In *Pennsylvania Elec. Co.*, as in this case, a public utility commission ordered the costs associated with an abandoned nuclear plant excluded from the participating companies' rate bases. However, when those companies filed complaints alleging that the rates were not just and reasonable and tariffs seeking rate increases, they were given a hearing and a rate increase—although not as large a one as they had requested.

They therefore appealed. *Pennsylvania Elec. Co.*, 502 A.2d at 132, 134. Jersey Central has been afforded no hearing, unlike Metropolitan Edison, and the Commission in this case has ignored, rather than balanced, the factors that the Pennsylvania court has said ought to be weighed.

[5]The dissent argues that it is inappropriate to use calculations involving the rate base to address the financial problems suffered by utilities. Dissent at 1203-1204. But we do not hold that the Commission *must* adjust the rate base or that it *must* make any specific form of adjustment, or even any adjustment at all. It is only required to hold the "end result" hearing discussed in *Hope*. After the hearing it *may* be determined that adjustments need to be made to the Jersey Central rate order, but we express no view as to the precise manner in which any such adjustments would have to be made, so long as whatever is done is satisfactory. On a different front, the dissent speculates that the Commission's actions may only affect a minor portion of Jersey Central's business, and that it would be wrong for the Commission to grant full relief for all of the utility's financial problems. Dissent at 1206–07. We of course do not require the Commission to take such broad steps; we only require it to hold the hearing mandated in *Hope* and to consider whether *any* adjustments, even perhaps partial adjustments, should be made in light of the factors discussed in *Hope*.

from that advanced by the Commission. Intervenors urge that we affirm the Commission on the sole ground that Jersey Central made the wrong filing. The dissent agrees.

The argument made by the dissent and the intervenors is purely procedural. They assert that the Commission has a "rule" against including the unamortized portion of an abandoned investment in the rate base; that Jersey Central "ignored" this "rule" when it made its filing; that Jersey Central could have "received what it wanted"—*i.e.*, a hearing before the Commission on its *Hope* claim—had it filed instead a request for a higher rate of return or a shorter amortization period; that those filings, in contrast to the filing actually made, would have been consistent with Commission rules; and that Jersey Central has therefore forfeited whatever claim it might have had to a higher rate, and, accordingly, that the summary dismissal ought to be affirmed. Supplementary Brief Submitted by Intervenors at 9–11, 14–15.

This procedural rationale, it is worth noting, was never advanced by the Commission: not in the orders under review, not at the original hearing before a panel of this court, not in its first response to the petition for rehearing, not in its second response, and not in its submission to the *en banc* court. Moreover, the point that the intervenors and the dissent seek to make the pivot of this case was not perceived by the panel in its unanimous first decision or by either the majority or the dissent in the panel's second decision. The point was not the reason we granted rehearing *en banc*. That was done entirely to rehear the *Hope* "end result" issue. The procedural argument was raised only at the *en banc* stage.

But the oddest aspect of this entire history is that the Commission has never said what the intervenors and the dissent say: that Jersey Central could have had a hearing on the *Hope* "end result" test if only it had followed some other procedure. The fact that the Commission never relied on this argument might be reason enough to reject it. And, in any event, because the Commission did rule that Jersey Central's proffer was inadequate, and thus committed legal error under *Hope*, it is not strictly necessary that we discuss the procedural point. The merits were reached and the claims were wrongly dispatched without any provision of the "end result" hearing required by *Hope*. Nonetheless, even though it makes no difference to the ultimate resolution of this case, we think it well to show this procedural contention is wrong. The intervenors' characterization of the utility's filing and its interpretation of the available Commission procedures do not withstand analysis.

A.

The intervenors and the dissent assert that in requesting rate-base treatment for the unamortized portion of the costs of the cancelled plant, Jersey Central violated the "rule" established by the Commission in *NEPCO*. There was, however, no suggestion in that case that the Commission was establishing any ironclad rule. The subject of that proceeding was the proper treatment of a cancelled generating unit at NEPCO's Salem Harbor facility. The Commission was faced with a number of issues, such as the length of the amortization period and the percentage of costs the utility would be permitted to amortize. It was also faced with the question of whether the unamortized portion of those costs should be included in the rate base. The Commission re-

solved that question by simply quoting from, and indicating its agreement with, the findings of the Administrative Law Judge, who had concluded that "[t]here is no precedent, or *reasonable justification in the record of this proceeding*, to require ratepayers to pay a return on an expenditure that has not resulted in productive plant that is used or useful in the public service." *NEPCO*, 8 F.E.R.C. (CCH) at 61,175 (emphasis added). The Commission had decided that application of the used and useful principle in that case, on the basis of the facts presented, would yield a reasonable balancing of the competing interests. It was not, as the intervenors suggest and the dissent states, establishing a rigid rule.

When NEPCO challenged the Commission's decision before this court, it was unsuccessful. *NEPCO Municipal Rate Comm. v. FERC*, 668 F.2d 1327 (D.C.Cir. 1981), *cert. denied sub nom. New England Power Co. v. FERC*, 457 U.S. 1117, 102 S.Ct. 2928, 73 L.Ed.2d 1329 (1982). NEPCO argued that *any* application of the used and useful principle that led to the denial of a return on prudently-invested capital was unconstitutionally confiscatory. We rejected that argument, and accepted that advanced by the Commission in its brief: "*In The Circumstances Of This Case*, The Commission Correctly Allowed The Utility To Recover Costs (But No Profit) For Cancelled Facilities," Brief for Respondent FERC at 18 (Argument Subheading I.B. 2) (emphasis added). We did not hold that the balance struck in *NEPCO* would be upheld in any future proceeding to which it was applied, regardless of the facts involved. Instead, we simply declined to hold, as urged by the utility, that failure to allow a return on prudently-invested capital was *per se* unconstitutional, and we affirmed the Commission's decision to employ the "used and useful" principle,

finding that NEPCO had "set forth no compelling reason for departing from that approach *in this case.*" *NEPCO*, 668 F.2d at 1335 (emphasis added).

In at least four subsequent proceedings, the Commission relied on *NEPCO* in summarily excluding the unamortized costs of cancelled plants from the rate base. While the intervenors overstate the matter by referring to the *NEPCO* precedent as a rule, it is fair to say that application of the precedent to routine cases like those was becoming a practice. Jersey Central's filing, however, was anything but routine. It presented allegations suggesting material differences between its situation and those presented in the *NEPCO* line of cases. First, the amount of the loss was on an entirely different scale. The Commission had never applied *NEPCO* to a loss at the order of magnitude of nearly $400 million. (*Ohio Edison Co.*, 18 F.E.R.C. (CCH) ¶ 61,010 (Jan. 8, 1982), for example, involved a loss of $773,146.) Second, in none of the previous cases had the petitioner suggested that it was facing financial distress of the sort threatening Jersey Central. Third, Jersey Central's filing proposed an amortization period three times longer than that established in *NEPCO*. A longer amortization period strikes a balance more favorable to ratepayers, and Jersey Central was apparently willing to accept lower revenues in exchange for the higher recorded earnings which would have accompanied rate-base treatment of the cancelled plant, since it needed to record earnings in order to regain its access to the capital markets.

These factual differences distinguishing *NEPCO* from the case before us are substantial. In *Michigan Wisconsin Pipe Line Co. v. FPC*, 520 F.2d 84 (D.C.Cir. 1975), we

explained that "the Commission may attach precedential, and even controlling weight to principles developed in one proceeding and then apply them under appropriate circumstances in a stare decisis manner." *Id.* at 89. In that case, however, the Commission's decision to attach such weight to a prior proceeding was remanded, because

> a rudimentary prerequisite to such an application is that the factual composition of the case to which the principle is being applied bear something more than a modicum of similarity to the case from which the principle derives. This is not to say that factual patterns must be virtually identical for a principle to control, but rather that there is a point where the patterns are so diverse that a per se application of the principle, without at least recognition and accommodation of the factual distinctions, brings into question the rationality of the application.

Id. Given the importance of a utility's financial condition to the balancing required of the Commission, and Jersey Central's willingness to accept smaller revenues in order to record higher earnings so as to maintain that integrity, Jersey Central must have thought, as we do, that it had presented allegations that required reasoned examination, not summary dismissal in reliance on a precedent dealing with vastly different facts.

Trailblazer Pipeline Co., 18 F.E.R.C. (CCH) ¶ 61,244 (Mar. 12, 1982), presented Jersey Central with some additional grounds for believing that the Commission would take a more flexible approach. While the procedural posture was different—this was not a rate filing, but a proceeding brought to obtain Commission certification to construct and operate a gas pipeline—the Commission discussed in its opinion what rate treat-

ment would be accorded gas projects in the event of abandonment. When prudent, conventionally-financed projects were cancelled, the Commission indicated that the company would be able to recover debt service and a return of, but not on, the equity portion of the investment. *Id.* at 61,502–03. The Commission explained in a footnote:

> The rationale is that while companies should be able to recover the amount of their investment in failed projects, they should not be allowed to profit from their failures. Correlatively, loss of the time value of their equity in failed projects represents a reasonable sharing with ratepayers of the losses of a failed project.

Id. at 61,511 n. 17. The application of these principles to electric utilities was suggested by the Commission's statement that "[t]here is no obvious reason why the treatment of abandoned plant costs as between gas and electric companies should differ." *Id.* at 61,511 n. 15. And though this statement was made in a context where electric companies are treated more generously than gas companies, *see id.* at 61,511 & n. 15, the clear implication was that treatment of the two should in every sense be the same. Given *Trailblazer's* holding that gas companies would be able to recover debt service and a return of, but not on, the equity portion of the investment, *id.* at 61,502–03, this statement strongly suggests that the Commission would also consider extending the same treatment to electric companies.[6]

[6] In our discussion of *Trailblazer* in *Jersey Central I*, 730 F.2d at 820, we stated that "the treatment accorded the pipelines, if applied here, would not permit Jersey Central to recover its equity investment, the debt, the carrying charges on the debt, and the preferred stock costs." We were in error. While project-financed pipelines were to waive their right to recover the equity investments, the Commission expressly distinguished conven-

(footnote continued on next page)

The proposed pipeline in *Trailblazer* was financed through project financing. The discussion of conventionally-financed projects was not, however, *dicta*. The Commission was presenting Trailblazer Co. with a choice between conventional and project financing, and explaining the consequences of each alternative. The Commission was offering to be bound by the rule it laid down for conventional financing if Trailblazer elected to proceed in that fashion. *Trailblazer's* discussion of "Commission policy with respect to abandoned plant," 18 F.E.R.C. (CCH) at 61,501, plausibly led Jersey Central to believe that what the intervenors and the dissent characterize as a well-established rule in fact was open to further evolution. Indeed, the Commission's discussion of the question (published two weeks before Jersey Central made its filing) was prompted by its recognition that "Commission treatment of the issue of abandoned plant in rate proceedings has been uncertain. In fact, it has been characterized by a somewhat distressing degree of inconsistency. That inconsistency is important because it tends to leave both lenders and equity investors with a sense of uncertainty. . . ." *Id.*[7]

tionally-financed pipelines in its discussion on the ground that conventionally-financed pipelines involve a higher risk of shareholder exposure to loss, thus suggesting that the latter will not be required to waive their right to recover the equity investments. 18 F.E.R.C. (CCH) at 61,503–04. And recovery of the remaining costs would be allowed on the theory that the loss of a return *on* (not *of*) common equity would constitute the company's share of the burden imposed by the cancellation.

[7] This lingering uncertainty about what the intervenors and the dissent so confidently label a "rule" is indicated also by the fact that the Commission's policy, which as we have shown has never been clear or settled, is still in a state of flux. The Commission has now initiated a rulemaking proceeding in order to consider the establishment, for the first time, of a genuine rule with respect to the treatment of cancelled plants. *See* 31 F.E.R.C. (CCH) ¶ 61,376 (June 28, 1985); Regulation of Electricity Sales-for-Resale and Transmission Service, 50 Fed.Reg. 27,604, 27,612–14 (1985).

The intervenors' and the dissent's characterization of Jersey Central's filing as an intentional deviation from the Commission's "rules" is an unreasonable one. There was no reason for the company to adopt a suicidal course and it is wrong to impute an intent for which there is no evidence. This characterization is particularly unfair since, under that analysis, one must read into the filing an implied waiver of statutory and constitutional rights. Jersey Central was not mounting a frontal assault on a firm rule. To the contrary, it argued throughout the proceedings below that the cases in which the practice had developed were not similar enough to what was now at issue to warrant their application as dispositive precedent, and that recently articulated Commission policy and the threat in Jersey Central's situation to the investor interests that the Supreme Court had deemed protected required some consideration more detailed than that given by summary dismissal.[8]

B.

Essential to the intervenors' and the dissent's analysis is the assertion that Jersey Central had other means of getting the hearing it sought. It is only by positing alternative filings through which Jersey Central would have received a hearing on financial integrity that the intervenors and the dissent are able to place the responsibility for what occurred on the utility. Quite clearly,

[8]As the dissent notes, it is clear that Jersey Central did not structure its filing to conform to *Trailblazer*. Dissent at 1201. Yet it did rely heavily on *Trailblazer* in its argument for rehearing before the Commission, as well as in its arguments before the first panel, second panel, and *en banc* panel of this court. *See, e.g.*, Initial Brief of Jersey Central *passim*. In any event, the more important point is simply that *Trailblazer* offers further evidence of the uncertainty that surrounds this issue and belies any characterization of the Commission's practice as a rigid rule.

the Commission may not maintain a system of rules that provides no opportunity at all for *Hope* allegations to be raised, heard, considered, and made the subject of findings. Yet that opportunity is precisely what the Commission tells us it routinely denies. For this reason, too, the intervenors' and the dissent's argument fails.

As noted earlier, *supra* p. 1179, the Commission in its brief will say only that it "*may* also look to the criteria of *Hope* in determining whether its rate order is just and reasonable." There is in that no promise of a *Hope* hearing under any circumstances; only a declaration that one is not required.

The following exchange from the *en banc* oral argument further illuminates the Commission's belief that it owes no one a hearing on *Hope* issues:

> COURT: Suppose everything else in this case were the same, you would apply the NEPCO rule, et cetera, but the utility came in with even stronger showing and they came in and showed that if this rate went into effect, by God, they would be the first utility in the history of American utilities to go into actual bankruptcy or—
>
> COUNSEL: I think there is no—
>
> COURT: Let me finish the question.
>
> COUNSEL: All right.
>
> COURT: If that kind of showing were made, do you think that the Commission under Hope Natural Gas had a responsibility to, despite the fact that it applied some general rules, to look at the situation and say, gee, the end results are pretty scary and maybe we had better do some fooling around with—
>
> COUNSEL: I think the answer is yes, Your Honor, and it reminds us of the—

COURT: Well, my second question then is do you, and, if so, how? In most cases that are close, a little closer than that, do you do anything comparable at the end of the day after you have applied the NEPCO and other rules, to look back over your shoulder and say this is the situation, we ought to do some tinkering around and, if so, *do you make any such findings?*

COUNSEL: The answer to the question is yes, we do tinker around after we pursue these normal ratemaking policies. And the tinkering around or making those pragmatic adjustments, the nice adjustments is the way the Commission has in the past viewed its responsibility under the end result test—

COURT: *Do we ever know, do we—*

COUNSEL: *No, you don't. As long—*

COURT: *We don't know whether you did that or not?*

COUNSEL: *It essentially turns on the rate of return, the tinkering with the rate of return.*

Tr. at 28-30 (emphasis added). The Commission's apparent practice of taking these issues into account by "tinkering" and without making open, factual findings follows quite naturally from its mistaken premise that meaningful judicial review of these decisions is never, or almost never, in order. For us to hold now that Jersey Central could have had its *Hope* claim considered had it made a different filing would be to rest upon a theory that the Commission has never put forward, indeed, a theory the Commission apparently has rejected.

The only constant in these proceedings has been the Commission's manifest hostility to serious "end result" examination under *Hope*. That alone can account for the

Commission's peremptory ruling on the merits. That hostility, and not the Commission's desire, made clear only in this proceeding, to elevate its used-and-useful principle to the status of an impregnable barrier, appears to underlie the Commission's abrupt and uninformative procedural rulings. At the time of Jersey Central's filing, counsel could well have concluded that used-and-useful was a rule of thumb that would be modified when circumstances warranted. But if the Commission wished to eliminate its previous circumstance-bound enunciation of the rule and to make it universal and unyielding, it should have allowed Jersey Central to get to the merits of its *Hope* "end result" claim in some other way. Instead, it met each of Jersey Central's renewed efforts with a fresh procedural rebuff and never once gave the slightest indication of how Jersey Central could get the hearing it sought.

The intervenors and the dissent suggest that Jersey Central could have requested a shorter amortization period, perhaps the period allowed in *NEPCO*, and received higher rates through that method. That technique would have been of little help, however, for while it would have led to quicker, higher *revenues*, Jersey Central needed to record *earnings* in order to lay a foundation for the issuance of securities and regain access to the capital markets. That could not be done through faster recovery of costs.

The intervenors and the dissent also state that Jersey Central could have requested a higher rate of return, and, had it done so, would have received the *Hope* hearing it wanted. Given the excerpt we have quoted from oral argument, it is impossible to know why they believe that to be true. Nothing the Commission has

said provides any such assurance. To the contrary, when Jersey Central suggested a higher rate of return in its petition for rehearing, the Commission dismissed the request as presenting a "moving target." That maneuver was particularly pointless since it would merely have required the company to come back with a new filing requesting the same higher rate of return based upon the same data. The Commission thus saved no effort of its own but cost the company the higher return in the interval. (Of course, in the same order the Commission made it clear that a fresh filing would be futile.) The Commission could have entertained the company's request for a higher rate of return. Given the very unusual circumstances here, which may have amounted to a denial of constitutional rights, that course would not have jeopardized deployment of the "moving target" doctrine in the ordinary case.

The Commission has yet to articulate anything approaching a coherent conception of what *Hope* requires, when hearings and findings are necessary, which facts are relevant, or how judicial review of rate orders should proceed. It is clear that the Commission would not have granted Jersey Central a *Hope* hearing if the company had somehow anticipated and followed every one of the dissent's freshly-invented prescriptions. The Commission below and its counsel here have said as much. It is, therefore, preposterous to contend that the Commission's multiple failures with respect to the "end result" test were caused, and hence excused, by Jersey Central's alleged procedural intransigence.

IV.

The Commission is not precluded from employing "used and useful," or any other specific rate-setting for-

mula. It must ensure, however, that the resulting rate is just and reasonable. A remand will afford the Commission the opportunity to find the facts necessary to a determination of whether the rate order meets the requirements *of Hope Natural Gas*, and, if it finds that it does not, the Commission has the flexibility to determine how the rate order should be modified—whether through enlarging the rate base, increasing the rate of return, or a combination of both. That will fulfill its obligations under the law.

So Ordered.

STARR, Circuit Judge, concurring:

Although I agree with my dissenting colleagues that Jersey Central has mounted an ill-conceived and overly broad attack on the "used and useful" principle, *see* Dissenting Opinion at 1197, I am satisfied that under the circumstances presented this case must be returned to the Commission. For the reasons that follow, I concur in the opinion of the court and in the decision to vacate and remand the Commission's orders.

I

The Commission has acted cavalierly in this case. As the court's opinion persuasively demonstrates, the Commission failed to take seriously the allegations of severe financial plight confronting Jersey Central. Its discussion of that plight is intolerably terse. In its order to reconsideration, the Commission stated that no testimony or exhibits had been proffered to justify a higher return. Yet the allegations of financial plight were highly detailed and specific, indicating that the utility was skating on the edge of bankruptcy.

The Commission's stated justification for summarily dismissing these allegations was the weight of its prior "used and useful" precedent. But as the court's opinion shows, that body of precedent did not constitute as ironclad a rule as the Commission would have us believe. It is certainly not evident from those precedents that the rule could be summarily applied in the face of the financial demise of the regulated entity.

Indeed, the Commission as a matter of policy has departed over the years from the strictures of the "used and useful" rule. This is illustrated by its treatment of "construction work in progress" (CWIP), part of which, the Commission recently determined, can be included in a utility's rate base. *See Mid-Tex Electric Corporation v. FERC*, 773 F.2d 327 (D.C.Cir.1985). In that proceeding, the Commission recognized that its own practice admits of "widely recognized exceptions and departures" from the "used and useful" rule, particularly when there are countervailing public interest considerations." *See* 48 Fed.Reg. 24,323, 24,335 (June 1, 1983) (CWIP final rule). In that setting, financial difficulties in the electric utility industry played a significant role in the Commission's decision to bend the rule. *See id.* at 24,332; 773 F.2d at 332-34. *See also, e.g., Tennessee Gas Pipeline Co. v. FERC*, 606 F.2d 1094, 1109-10 (D.C.Cir.1979) (departure from "used and useful" to permit rate base treatment of natural gas prepayment is justified as means of encouraging development of additional gas reserves), *cert. denied*, 445 U.S. 920, 100 S.Ct. 1284, 63 L.Ed.2d 605 (1980).

This policy of flexibility, it seems to me, reflects the practical reality of the electric utility industry, namely that investments in plant and equipment are enormously costly. Rigid adherence to "used and useful" doc-

trines would doubtless imperil the viability of some utilities; thus, while not articulating its results in *Hope* or "takings" terms, the Commission—whether as a matter of policy or perceived constitutional obligation—has in the past taken these realities into account and provided relief for utilities in various forms.

What the Commission now confronts in Jersey Central's rate filing is an investment, prudent when made, in a nuclear power facility that was doomed to failure. The cost of that project prior to abandonment was enormous—$397 million. Under these circumstances, the Commission, in order to engage in reasoned decisionmaking, has a duty to consider the entire financial circumstances confronting the utility, as it did in the CWIP context, not to rely blindly on precedents which do not involve similarly situated utilities facing the most dire financial consequences. Should the Commission nonetheless choose to adhere to the "used and useful" principle in these circumstances, it must provide a reasoned explanation for that decision. "Judicial review of the Commission's order [ ] will . . . function accurately and efficaciously only if the Commission indicates fully and carefully the methods by which, and the purposes for which, it has chosen to act, as well as its assessment of the consequences of its order [ ] for the character and future development of the industry." *Permian Basin Area Rate Cases*, 390 U.S. 747, 792, 88 S.Ct. 1344, 1373, 20 L.Ed.2d 312 (1968). It is scarcely reasoned decisionmaking to dismiss out of hand allegations that go to the heart of the utility's financial viability.

II

The Commission's arbitrary and capricious treatment of the issues presented by Jersey Central necessitates

the return of this case for further proceedings. The specific questions on remand will be whether the Commission's treatment of Jersey Central's request is consistent with prior precedent and whether the rate order entered in this instance violates *Hope*'s "end result" test. To address the latter question, it will be necessary to take into account the constitutional considerations at stake, namely whether the rate order or any other agency action which preceded that order worked a "taking" within the compass of the Fifth Amendment's Takings Clause. Those would appear to be novel issues for a Commission that seems determined to avoid an "end result" inquiry as such, while at the same time making various adjustments to bring relief to troubled parts of the electric utility industry. Under these circumstances, a comment or two is in order as to why I have concluded that, notwithstanding the Commission's agnosticism, Jersey Central's complaint "sounds" in the constitutional demands of the Fifth Amendment. Whether the facts would indeed make out a constitutional violation is obviously not before us, Majority Opinion at 1174, and must await the *Hope* mandated hearing which must now be held.

The utility business represents a compact of sorts; a monopoly on service in a particular geographical area (coupled with state-conferred rights of eminent domain or condemnation) is granted to the utility in exchange for a regime of intensive regulation, including price regulation, quite alien to the free market. *Cf. Permian Basin*, 390 U.S. at 756–57, 88 S.Ct. at 1354–55 (unlike public utilities, producers of natural gas "enjoy no franchises or guaranteed areas of service" and are "intensely competitive"). Each party to the compact gets something in the bargain. As a general rule, utility in-

vestors are provided a level of stability in earnings and value less likely to be attained in the unregulated or moderately regulated sector; in turn, ratepayers are afforded universal, non-discriminatory service and protection from monopolistic profits through political control over an economic enterprise. Whether this regime is wise or not is, needless to say, not before us. *See generally* Posner, *Natural Monopoly and Its Regulation*, 21 Stan.L.Rev. 548 (1969); Demsetz, *Why Regulate Utilities?*, 11 J. Law & Econ. 55 (1969).

In the setting of rate regulation, when does a taking from the investors occur? It seems to me that it occurs only when a regulated rate is confiscatory, which is a short-hand way of saying that an unreasonable balance has been struck in the regulation process so as unreasonably to favor ratepayer interests at the substantial expense of investor interests. Thus, in my view, a taking does not occur when financial resources are committed to the enterprise. That is especially so since a utility's capital investment is made not simply in satisfaction of legal obligations to provide service to the public but in anticipation of profits on the investment. The utility is not a servant to the state; it is a for-profit enterprise which incurs legal obligations in exchange for state-conferred benefits. A profit-seeking capital investment is scarcely the sort of deprivation of possession, use, enjoyment, and ownership of property which can conceptually be deemed a taking. *See generally* R. Epstein, *Takings* 63–92 (1985). Indeed, it would seem odd to consider as a taking government's disavowal of any interest in property which remains unregulated and which reflects a profit-seeking investment.

It is also of significance to the constitutional inquiry whether the regulators forbade completion of construc-

tion. *Cf. In re Public Service Co.*, 122 N.H. 1062, 454 A.2d 435 (1982) (holding that under the New Hampshire constitution, the State cannot prevent completion of construction of the Seabrook nuclear power facility without providing just compensation). *But see Penn Central Transportation Co. v. City of New York*, 438 U.S. 104, 98 S.Ct. 2646, 57 L.Ed.2d 631 (1978) (New York City historic preservation law employed to forbid development of office building). It would seem that, at least conceptually, a taking of investment funds in the Forked River project would have occurred if government so regulated as to prevent the property, in whole or in part, from being employed in the manner desired by the owner. But as we know, these conditions did not occur.

Nor would a taking (*pro tanto*) automatically occur when regulation itself takes place, for that was part of the original compact between investors and the state. Rate regulation is, in theory, the substitute for competition. The state stands in the shoes, as it were, of competitors, keeping the utility within bounds that would be drawn by market forces in a non-monopolistic market. Whether economically sound or not, utility rate regulation in itself raises no constitutional concerns.

Under one line of analysis, inclusion of prudent investments in the rate base is not in and of itself exploitative. *See Washington Gas Light Co. v. Baker*, 188 F.2d 11 (D.C.Cir.1950), *cert. denied*, 340 U.S. 952, 71 S.Ct. 571, 95 L.Ed. 686 (1951). I am not so sure that such an easy rule can automatically be properly employed consistent with the demands of the Fifth Amendment. Prudence is, of course, relevant to the process of striking a reasonable balance in rate-setting for public utilities. Requiring an investment to be prudent when made is one safeguard imposed by regulatory authorities upon

the regulated business for benefit of taxpayers. As I see it, the "used and useful" rule is but another such safeguard. The prudence rule looks to the time of investment, whereas the "used and useful" rule looks toward a later time. The two principles are designed to assure that the ratepayers, whose property might otherwise of course be "taken" by regulatory authorities, will not necessarily be saddled with the results of management's defalcations or mistakes, or as a matter of simple justice, be required to pay for that which provides the ratepayers with no discernible benefit.[1]

The two principles thus provide assurances that ill-guided management or management that simply proves in hindsight to have been wrong will not automatically be bailed out from conditions which government did not force upon it. That is, government forced upon the utility an obligation to provide service, but that obligation, as we have seen, is the *quid pro quo* for a protected area of service (and eminent domain authority). What is fundamental is that government did not force upon the utility a specific course of action for achieving the mandated goal.

Indeed, it would be curious if the Constitution protected utility investors entirely from business dangers experienced daily in the free market, the danger that managers will prove to have been overly sanguine about business prospects or the danger that a particular capital investment will not prove successful. In the face

[1]The obvious danger in not examining both ends of the continuum—both the prudence of the investment and whether the end result of the investment was used and useful—is to build in pressures for building excess generating capacity. The "used and useful" rule operates as a restraining principle, reminding utility managers that they must assume the risk of economic forces working against an investment which is prudent at the time it is made.

of anticipated demand, an airline may acquire additional aircraft, only to face unhappy consequences when passenger traffic does not meet expectations, perhaps due to economic factors entirely beyond management's control. Utilities are not exempt from comparable forces.[2] As the cases have repeatedly held, the Fifth Amendment does not provide utility investors with a haven from the operation of market forces. *See, e.g., FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 590, 62 S.Ct. 736, 745, 86 L.Ed. 1037 (1942) ("[R]egulation does not insure that the business shall produce net revenues."). Yet, the prudent investment rule, in full vigor, would accomplish virtually that state of insulation, all in the guise of preventing government from effecting a taking without just compensation.

For me, the prudent investment rule is, taken alone, too weighted for constitutional analysis in favor of the utility. It lacks balance. But so too, the "used and useful" rule, taken alone is skewed heavily in favor of ratepayers.[3] it also lacks balance. In the modern setting,

[2]The comparison is, of course, imperfect since the airline will enjoy the full fruits of financial success if its acquisition program succeeds. A utility's rate of return, in contrast, is limited by regulation. On the other hand, the airline is not provided with the protection of a regulatory body's interest in preserving the financial soundness of the enterprise.

[3]I recognize that venerable authority supports firm adherence to "used and useful" precepts. In *Denver Union Stock Yard Co. v. United States*, 304 U.S. 470, 58 S.Ct. 990, 82 L.Ed. 1469 (1938), for example, the Supreme Court (in an opinion joined by Justice Brandeis, the leading proponent of the prudent investment approach) embraced the "used and useful" rule in the following language:

> *The rate base.* As of right safeguarded by the due process clause of the Fifth Amendment, appellant is entitled to rates, not *per se* excessive and extortionate, sufficient to yield a reasonable rate of return upon the value of property used, at the time it is being used, to render the services. *But it is not entitled to have included any property not used and useful for that purpose.*

(footnote continued on next page)

neither regime, mechanically applied with full rigor, will likely achieve justice among the competing interests of investor and ratepayers so as to avoid confiscation of the utility's property or a taking of the property of ratepayers through unjustifiably exorbitant rates. Each approach, however, provides important insights about the ultimate object of the regulatory process, which is to achieve a just result in rate regulation. And that is the mission commanded by the Fifth Amendment. Unlike garden-variety takings, the requirements of the Takings Clause are satisfied in the rate regulatory setting when justice is done, that is to say the striking of a reasonable balance between competing interests.

Thus it is that a taking occurs not when an investment is made (even one under legal obligation), but when the balance between investor and ratepayer interests—the very function of utility regulation—is struck unjustly. Although the agency has broad latitude in striking the balance, the Constitution nonetheless requires that the end result reflect a reasonable balancing of the interests of investors and ratepayers. As we have seen, both investors and ratepayers were the intended beneficiaries of the Forked River investment; both should presumptively have to share in the loss.[4] Filling in the gaps, the making of the specific judgments

Id. at 475, 58 S.Ct. at 994 (citations omitted) (emphasis added). But it seems to me that this language was not meant to state an absolute and unchanging constitutional rule regardless of the nature of the investment and the impact of the rate order. The Court's subsequent teaching in *Hope* makes it clear that no specific methodology is either inherently infirm or sacrosanct.

[4]In like manner, a regulatory order requiring ratepayers to pay monopolistic prices would fail to achieve the constitutionally required balance of interests. That sort of order would work a taking of ratepayers' property, assuming the public purpose requirement of the Takings Clause had been met.

that constitutes the difficult part of this enterprise, belongs in the first instance to the politically accountable branches, specifically to the experts in the agency, not to generalist judges.

It is here that *Hope's* "end result" test comes into play. The judiciary is not to micromanage the rate regulation process, just as we are to be restrained in reviewing the other work of administrative agencies. We are not to impose procedures that we think are wise or methodologies that we think strike a better balance than that struck by the regulators. Our limited but vital role is to ensure that the end result of a rate order reasonably balances investor and ratepayer interests.

We are, fortunately, not left completely in a web of subjectivity in making these judgments. To be sure, Takings Clause law has not been marked by analytical consistency, as Professor Epstein has brilliantly demonstrated in his recent book. Nor has it been characterized, as much as we might care for them, by bright-line rules. In the words of then-Justice Rehnquist speaking for the Court in *Kaiser Aetna v. United States*, 444 U.S. 164, 175, 100 S.Ct. 383, 390, 62 L.Ed.2d 332 (1979), the inquiry is "essentially ... ad hoc [and] factual" in nature. Nonetheless, we have been taught that several factors are worthy of consideration in determining whether regulation works a taking, including "the economic impact of the regulation, the extent to which it interferes with investment-backed expectations, and the character of the governmental action." *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 432, 102 S.Ct. 3164, 3174, 73 L.Ed.2d 868 (1982); *see also PruneYard Shopping Center v. Robins*, 447 U.S. 74, 83, 100 S.Ct. 2035, 2041, 64 L.Ed.2d 741 (1980); *Kaiser Aetna*, 444 U.S. at 175, 100 S.Ct. at 390.

While it is premature to pass ultimate judgment on the question, some preliminary observations are in order. The first of the three considerations enumerated in Supreme Court decisions points powerfully in favor of Jersey Central. Forked River represents an enormous loss, and the very enormity of it must weigh heavily in the balance. No one maintains that exclusion of the abandoned plant from the rate base is *de minimis*, not affecting the return on property. *Cf. Loretto*, 458 U.S. at 445, 102 S.Ct. at 3181. (Blackmun, J., dissenting); *PruneYard*, 447 U.S. at 83, 100 S.Ct. at 2041. To the contrary, Jersey Central represents that it is perilously close to the edge of bankruptcy, unable to secure long-term credit, and unable to attract capital to the enterprise.

The second consideration—the extent to which the agency's action interferes with investment-backed expectations—is mixed. As a general rule, it would appear that investors purchase utility stock as a mechanism for conservative, safe investments. Drobak, *From Turnpike to Nuclear Power: The Constitutional Limit on Utility Rate Regulation*, 65 B.U.L.Rev. 65, 106–107 (1985). Potentially high rewards are foresworn in favor of stability and safety. And now the situation of Jersey Central's investors is grim. There is no prospect, we are told, for those investors to earn a return on their investment. Thus, in holding over strenuous dissents that no taking was occasioned by New York City's interference with Penn Central's plans to erect an office building atop Grand Central Station, the Supreme Court emphasized that the property owner could still earn a reasonable return on the investment notwithstanding the restrictive effects of the historic preservation law.[5] Jersey Central's

[5]Needless to say, this analysis does not respond to the objection that a *partial* taking, as opposed to a complete deprivation of property, was being effected.

investors have nothing but bleak days ahead, we are told, unless regulatory relief is forthcoming.[6]

On the other hand, FERC has already moved somewhat in the direction of balancing competing interests by permitting recovery of the costs of building the plant in the cost of service. Investor interests have not, therefore, been entirely ignored. In addition, as I indicated above, utilities are not shielded by the Constitution from the forces of competition and the uncertainties of economic life, and investors purchasing common stock are after all engaged in economic risk-taking. In addition, it surely cannot be reasonable for an investor to assume that each and every expenditure by a utility will be allowed by regulatory authorities. The very existence of regulation carries with it the hard fact that not every rate increase will be granted, not every expenditure will be allowed. Yet, "reasoned consideration" of investor interests requires more than the mechanical application of everyday rules to the loss of a $397 million investment in a power plant. *Permian Basin*, 390 U.S. at 792, 88 S.Ct. at 1373.

Finally, the character of the government action weighs for takings analysis in favor of the agency. The classic taking is when government invades and possesses property, partly or entirely. Permanent physical occupation provides the clearest example. *United States v. Lynah*, 188 U.S. 445, 468–70, 23 S.Ct. 349, 356–57, 47 L.Ed. 539 (1903). Occupation can, of course, be partial,

[6]It also goes without saying that Jersey Central's rate woes cannot in any event be laid entirely at the feet of FERC. It appears that state regulatory authorities, whose orders have considerably greater economic effect on Jersey Central than federal directives, have been inhospitable to efforts to include the Forked River plant in the state-regulated rate base. If that is so, relief from Draconian regulation in Trenton cannot come from Washington, D.C.

and the taking can be the consequence of a private invasion if accomplished under the state's auspices. *Loretto*, 458 U.S. 419, 102 S.Ct. 3164, 73 L.Ed.2d 868 (1982). A taking can occur when government imposes a right of access on private property, at least when the landowner had reasonably relied on government consent in making the improvements that purportedly opened the property to uninvited outsiders. *Kaiser Aetna*, 444 U.S. 164, 100 S.Ct. 383, 62 L.Ed.2d 332 (1979). The latter case teaches that the elimination of a basic incident of ownership—the right to exclude unwanted visitors from property—can constitute a taking. And, while the issue was sharply disputed in the Court and the resolution seemingly in conflict with *Kaiser Aetna*, it appears from the *PruneYard* case that the conduct of the landowner is of relevance in the constitutional analysis. That case teaches that willfully surrendering one of the "bundle" of property rights may result in greater, state-protected intrusion by outsiders than the property owner intended. Specifically, a shopping center owner may find that individuals may be permitted, over his objection, to exercise certain noncommercial rights on the shopping center property.[7] *PruneYard*, 447 U.S. at 83, 100 S.Ct. at 2041. Thus, in contrast to *Kaiser Aetna*, the owner of the PruneYard Shopping Center found that he had lost the right to exclude some visitors by issuing an invitation to the public generally to visit the center for commercial purposes.[8]

[7]Like *Penn Central*, this analysis does not squarely address the argument that a *pro tanto* taking has occurred, which, as *Kaiser Aetna* taught, demands compensation under the Takings Clause.

[8]Whatever its analytical strengths, the *PruneYard* opinion took pains to emphasize the limited nature of the intrusion by the petition-seekers. Surely the commercial invitation of the PruneYard center's owner would not permit a political candidate to set up campaign operations in the mall's

(Footnote continued on following page)

The nature of the government action in this case obviously seems unintrusive in contrast to more typical takings cases. There has been no invasion, temporary or permanent. As I have previously indicated, the regulatory entity has not forbidden the Forked River project to proceed. What government has done is to forbid the investment to garner a return, thus balancing competing principles of utility regulation. Forbidding a profit on an investment gone sour strikes me, conceptually, as recreating in part the marketplace environment; indeed, FERC's permitting recovery of the investment itself through cost of service works an interference with what would otherwise occur in the unregulated setting, since the investors as risk takers would obviously bear the entire risk that the investment would not pan out. In addition, FERC's obligation to consider consumer needs and expectations must be evaluated in determining whether its order arbitrarily limited the return to investors. *Permian Basin*, 390 U.S. at 769, 88 S.Ct. at 1361 ("[I]nvestors' interests provide only one of the variables in the constitutional calculus of reasonableness.").

But it is not for us to finally resolve these questions in the first instance. That job, as I have said, belongs to regulators, not judges. *See Permian Basin*, 390 U.S. at 792, 88 S.Ct. at 1373. In my view, this case must now be resolved by the Commission, facing up to the hard question of whether, under all the circumstances, a violation of *Hope* has been worked by this rate order. That determination, it seems to me, can only be made by a careful balancing of the competing considerations that are inevitably present in the setting of utility

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common areas, or for the mall to serve as a makeshift lecture hall on foreign policy or a practice field for the local marching band on rainy days.

regulation. *Id.* While I am unable to pass judgment on the ultimate issue in this case, I am convinced that FERC has completely failed to come to grips with the question and that the question is now squarely before it for resolution.

MIKVA, Circuit Judge, with whom Chief Judge WALD, and Circuit Judges SPOTTSWOOD W. ROBINSON, III and HARRY T. EDWARDS join, dissenting:

After two prior opinions, confounded by the Commission's ever-shifting position, it is small wonder that this court is having difficulty seeing the forest for the trees. In its attempt to beat a clear path to resolution of the issues, however, the majority treads with heavy foot over some well-held doctrines regarding takings, unreasonableness of return, and the obligation of the Federal Energy Regulatory Commission (the Commission or FERC) to guarantee the financial solvency of a utility. Perhaps the greatest damage is rendered by the implications of the majority opinion for the scope of judicial review of Commission ratemaking procedures. Although we believe the Commission has been less than forthright in defending its action, we cannot join in the havoc our colleagues have wreaked in order to slap its hands.

The ramifications of today's decision are inescapably broad. Whenever a utility files a proposed rate schedule and alleges that the revenues and earnings contemplated produce the "minimum amount" necessary for it to have access to capital markets and to maintain its financial integrity, the Commission is constrained to take no interim rate-reducing action without first holding a hearing and making findings pursuant to the test

formulated in *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1944). The majority reads *Hope* as authorizing the court to direct FERC, when faced with such allegations, to abandon its otherwise permissible summary disposition procedures. This holding constitutes a blatant interference with the ratemaking procedures adopted by the Commission. Such intrusion into the Commission's authority would have been deemed outrageous even in the days before *Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc.*, 435 U.S. 519, 98 S.Ct. 1197, 55 L.Ed.2d 460 (1978). We cannot believe that it is unobjectionable in this age of judicial deference. Therefore, we respectfully dissent.

I. Background

A full appreciation of the impact of today's decision requires an understanding of the posture in which this case comes to us. At an intermediate stage of the ratemaking proceeding, the Commission summarily rejected a non-conforming portion of Jersey Central's filing pursuant to longstanding policy and procedure. Jersey Central loudly complained and refused to go further with the ratemaking process. In rushing headlong into the *Hope* issue, the majority loses sight of what we have here—Jersey Central is attempting to convert its rate case into a rulemaking proceeding. The majority allows the utility to succeed. It responds to Jersey Central's complaints by directing FERC to abandon agency rules as applied to the utility and to implement the utility's rates according to procedures the Commission would not normally follow.

On March 31, 1982, Jersey Central Power and Light Company (Jersey Central) filed a proposed two-phase

increase in its rate schedules for six wholesale customers. Phase A has gone into effect and is not at issue here. In Phase B, the utility proposed to amortize over 15 years a $397 million investment lost when it abandoned construction of a nuclear power plant project at Forked River, New Jersey. That is, Jersey Central sought to recover the project expenditure from its ratepayers as costs over time. It also sought to include in its rate base the current carrying charges (computed at 5.2%) on the debt and on the preferred stock portions of the unamortized investment in the plant. The total return a public utility captures is, simply put, the product of its permitted rate base and rate of return. Thus, the inclusion of the desired items in the rate base would generate a return on them over the amortization period; current ratepayers would bear the cost. The exclusion of these items from the rate base would require Jersey Central's common equity investors to bear a financial burden; they would not obtain a return on the investment and would pay current charges.

Jersey Central's wholesale customers protested the increased rates tendered for filing and petitioned the Commission to intervene in the ratemaking proceedings. Among other requests, the wholesalers moved for a partial rejection of the second phase of the rate filing. Adhering to its policy regarding abandoned investments, the Commission granted the wholesalers' motion for summary disposition of the rate base inclusion of the unamortized investment in the cancelled plant. Under settled FERC policy, expenditure for an item may be included in a public utility's rate base only when the item is "used and useful" in rendering service to the ratepayers. Accordingly, the Commission's interim order allowed amortization of the Forked River in-

vestment as requested, but required Jersey Central to exclude the unamortized items from its rate base. 19 FERC (CCH) ¶ 61,208 (May 28, 1982).

In ordering this exclusion, FERC relied on *New England Power Co.*, 8 FERC (CCH) ¶ 61,054 (July 19, 1979), *aff'd sub nom. NEPCO Municipal Rate Committee v. Federal Energy Regulatory Commission*, 668 F.2d 1327 (D.C. Cir.1981), *cert. denied*, 457 U.S. 1117, 102 S.Ct. 2928, 73 L.Ed.2d 1329 (1982) ("*NEPCO*"). *NEPCO* held that utilities could amortize the full investment loss suffered from abandoned projects, but could not include the unamortized portion of these investments in the rate base because the abandoned projects were not "used or useful." By following *NEPCO*, the Commission allowed Jersey Central to recover its total investment in the project to the point of cancellation, but denied the utility any return on the capital invested in the cancelled plant.

In concluding, the Commission ordered Jersey Central to file revised Phase B rates and cost support reflecting the summary disposition. The revision ordered would presumably be downward. Notably, because its preliminary review "indicate[d] that [the Phase B increase] may produce substantially excessive revenues," the Commission suspended implementation of Phase B and ordered that a public hearing be held "concerning the justness and reasonableness of [Jersey Central's] rates." 19 FERC (CCH) ¶ 61,208, at 61,404.

Jersey Central did not file the revised material ordered. Instead, on June 24, 1982, it applied for rehearing, requesting reconsideration of the summary disposition or, in the alternative, a higher rate of return than that originally proposed in order to compensate for its

diminished rate base. The Commission denied rehearing as to exclusion of the investment in the cancelled nuclear facility from the rate base. It noted that its decisions since *NEPCO* had reaffirmed the exclusion of current charges on unamortized investments. *Jersey Central Power & Light Co.*, 20 FERC (CCH) ¶ 61,083, at 61,181 (July 23, 1982). In rejecting Jersey Central's alternative proposed approach, the Commission ruled that the company could not support its revenue request on rehearing simply "by inflating the rate of return to recover dollars equal to those attributable to its impermissible rate base inclusion." *Id.* at 61,182. Pursuant to settled policy, the Commission refused to consider increasing the rate of return when that alternative was raised in the first instance on application for review without supporting documentation. *See id.*

After the denial of rehearing, Jersey Central again failed to revise its filings. Had it done so, an Administrative Law Judge (ALJ) would have held a hearing, pursuant to the Commission's initial order, on the "justness and reasonableness" of the rates. At this hearing, the wholesalers could have intervened and presented their arguments that the rates, although reduced from those originally proposed, were nonetheless excessive. *See* 19 FERC (CCH) ¶ 61,208, at 61,404. Similarly, Jersey Central could have testified as to its belief that the reduced rates were too low.

Furthermore, the utility had two additional avenues open to it. First, Jersey Central could have refiled for a proposed rate increase after its application for rehearing was denied by operation of law. *See* 18 C.F.R. § 385.714(f) (1986). In pointing out the inadequacies of Jersey Central's initial filing, the Commission clearly left the way open for a *new* rate proceeding that would

include testimony and exhibits supporting a higher rate of return, as required by the Commission's rules. *See id.* § 35.13 (1986). In such a request the utility could have proposed a shorter amortization period than that it had initially requested or offered evidence of cost of service elements justifying a higher overall return on the remaining assets in the rate base. Second, Jersey Central could have petitioned the Commission for a rulemaking concerning the continued validity of the "used and useful" principle when applied to cancelled plants generally. *See generally* Administrative Procedure Act, 5 U.S.C. § 553(e) (1982). At the proposed rulemaking proceeding, Jersey Central could have presented testimony in support of its position that the Commission's present used and useful policy unnecessarily penalizes utility investors. *See* 18 C.F.R. § 385.505 (1986). Instead of pursuing either, or both, of these administrative alternatives, Jersey Central appealed to this court.

The majority seems to have lost sight of the juncture at which we stand in reviewing the Commission's orders. It is too anxious to reach the end of the road. The majority contends that the Commission "reached" and "wrongly dispatched" Jersey Central's *Hope* claim. Majority Opinion (Maj. Op.) at 1183; *see also id.* at 1170. Its reasoning runs as follows: "The Commission ruled that Jersey Central's allegations and proffered testimony would not support a higher rate. That substantive ruling means that a hearing would have been pointless." *Id.* at 1170. Although the Commission's interim order has implications for the utility's *Hope* claim, this construction is unfounded. Furthermore, it makes a mockery of the Commission's order to hold a hearing on the very issue of the justness and reasonableness of the revised rates.

Contrary to the majority's postulation, it is not the Commission's position that it need not make an "end result" examination. *See id.* Throughout its briefings and arguments before this court, the Commission has allowed that it must construct a rate within the confines of the "zone of reasonableness" informed by *Hope*. Rather, the Commission maintains that it need not hold a hearing to make that inquiry before it excludes a nonconforming element from a proposed rate base—at least not on the facts alleged here. The "end result" inquiry is made at the end of the ratemaking process, not at an intermediate, summary disposition stage. Thus, a hearing on inclusion of the unamortized portion of the cancelled plant in the rate base would be "pointless." A hearing on the resultant rates would not be. In fact, as counsel for FERC explained at oral argument, it was the post-appeal settlement adjusting Jersey Central's rate of return that obviated the need for the rate hearing ordered by the Commission.

No one disputes Jersey Central's right to have the end result of the ratemaking proceeding subjected to a *Hope* inquiry. The issue is one of timing. FERC provided for a hearing on the adequacy of the rates allowed Jersey Central *after* the Commission's reduction. The final rate order that emanated from that hearing would in any event be subject to judicial review. *See Hope, supra.* Jersey Central demands a hearing *before* the reduction—now, not at the end. No wonder the majority and separate opinions complain of not having a record through which to examine the Commission's effort to balance the relevant interests. Maj.Op. at 1172, 1178; Separate Opinion (Sep.Op.) at 1188–89. Jersey Central elected to forego a hearing on the reduced rates and instead chose to clamor to this court for review of

the Commission's actions taken before the final balancing was performed. It is an interim rate-reducing order of which Jersey Central seeks review, not a final rate-setting order. The majority's decision to yield to Jersey Central's demands directly implicates the Commission's ratemaking authority and its capacity to exercise its valid, established procedures free of judicial improvements.

The question this court addresses is the question that Jersey Central reserved its right to appeal under the settlement agreement: whether the Commission acted properly in limiting the rate base to used and useful property. As the majority recounts, Maj.Op. at 1173, Jersey Central's challenge to the Commission's orders takes three principal tacks. The utility first claims that the Commission has not established a used and useful rule applicable to its proposed filing. Second, the utility claims that, even if there were such a rule, application of the doctrine under the circumstances would lead to unconstitutionally confiscatory rates; therefore, it contends, the Commission cannot summarily apply the rule and must provide an evidentiary hearing. Finally, Jersey Central complains that, in the alternative, it is entitled to a hearing on an increased rate of return on its initial filing.

The majority finds that there is no iron clad rule regarding rate base treatment of cancelled electric utility plants and holds that Jersey Central is automatically entitled to a hearing on its proposed filing. Our inquiry leads us to the firm conclusion that the Commission acted reasonably and that Jersey Central is not entitled to a hearing on rate base treatment of the unamortized cost items of its rate schedule or on an inflated rate of

return. The Commission followed established agency rules and procedures and Jersey Central cannot complain. There may be times when FERC is not free to summarily apply settled doctrine during the ratemaking process, but Jersey Central has not presented such a case.

II. The Commission's Application of the Used and Useful Rule

At the heart of Jersey Central's complaint is its dislike of the used and useful principle, especially as elaborated in *NEPCO, supra*. In its attempt to have the Commission reconsider the doctrine, Jersey Central argues that the precedent does not, or should not, apply to it. Unlike the majority, we find that, in *NEPCO* and subsequent cases, the Commission firmly established a valid rule for the calculation of rate base in electric utilities' rate filings. Unmoved by Jersey Central's endeavors to distinguish itself, we conclude that the Commission's summary rejection in this case precisely follows that precedent.

It is, of course, widely accepted that the Commission may develop principles in one proceeding and then attach precedential of even controlling weight to them in later proceedings. *See, e.g., Michigan Wisconsin Pipe Line Co. v. Federal Power Commission*, 520 F.2d 84, 89 (D.C.Cir.1975). And the Commission can properly implement that policy, in order to protect consumers, at the summary judgment stage of its proceedings. *See Municipal Light Boards v. Federal Power Commission*, 450 F.2d 1341 (D.C.Cir.1971), *cert. denied*, 405 U.S. 989, 92 S.Ct. 1251, 31 L.Ed.2d 455 (1972). The majority seems to have no quarrel with this premise. Like Jersey Cen-

tral, however, it disputes that the Commission had developed a principle or rule against including the unamortized portion of an abandoned investment in the rate base. Although not the ground on which it remands the proceeding, the majority implies that the application of the used and useful doctrine to Jersey Central's rate schedule was inconsistent with any practice established by the Commission. *See* Maj.Op. at 1185–86. The majority's reasoning distorts the NEPCO precedent established by the Commission, contradicts this court's interpretation of the doctrine, and manipulates inapposite Commission decisions.

A. *The NEPCO Approach*

The majority asserts that rather than establishing a general policy in *NEPCO*, the Commission was engaging in a case-specific balancing of interests. *Id.* at 1183. The majority thus conceives the crucial factor underlying *NEPCO* as the reasonable balance that was struck by the Commission's compromise between the NEPCO rate-payers and investors. In its view, the *NEPCO* decision was as much dependent on the length of the amortization period, the percentage of costs the utility would be permitted to amortize, and the size of the investment as it was on the question of whether the unamortized portion of those costs should be included in the rate base. *Id.* Therefore, because Jersey Central proposed a different amortization period, presented a much larger investment and faced financial distress, a fact not alleged in *NEPCO*, the utility had substantially distinguished itself from *NEPCO*. *Id.* at 1184. Under the majority's interpretation, the Commission must strike a new reasonable balance between ratepayers and investors in this case and cannot do so through summary

adjudication. The majority's interpretation jibes with neither the Commission's nor this court's decision. Moreover, it virtually destroys any usefulness of *NEPCO* as a substantive rule of *policy*.

NEPCO concerned the used and useful principle in general, not just as applied to one cancelled plant. In *NEPCO*, we approved the Commission's policy against permitting a utility to reap a return on the unamortized portion of its investment in an abandoned generating station. This policy is based on a principle of ratemaking upheld long ago by the Supreme Court: a utility may not include in its rate base properties that are not "used and useful" in serving its ratepayers. *See Denver Union Stock Yard Co. v. United States*, 304 U.S. 470, 475, 58 S.Ct. 990, 994, 82 L.Ed. 1469 (1938). Thus, in *NEPCO* the Commission allowed the utility to recover the money it owed on a partially constructed and then cancelled generating plant, but not to receive a return on that investment over the amortization period. Abandoned projects are neither used nor useful and therefore properly can be excluded from the rate base. Only as a result of that standard did the Commission note that a reasonable balance had been attained.

The ALJ's decision and the Commission's adoption of it were based clearly—and exclusively—on the used and useful principle. In selectively cribbing from the Commission's quote of the ALJ opinion, the majority strives to create the impression that the decision was fact-based. *See* Maj.Op. at 1184. Nothing could be farther from the truth. In reaching his conclusion, the ALJ indicated that "[t]he equitable method of handling this issue requires a balancing of the interest of ratepayers and security holders." J.A. in *NEPCO*, 668 F.2d at 1332. In balancing these interests, the ALJ made no

mention of the amortization period, or the size of the investment, or any other specific fact. Nor did the Commission make mention of such facts in adopting the ALJ's findings. In rejecting NEPCO's argument that ratepayers should be required to pay a return on the expenditure related to an aborted project, the Commission simply quoted from (and thereby indicated its agreement with) the ALJ's determinations:

> Ratepayers are not required to insure that a utility receive a return on all monies invested in the enterprise; ratepayers are required to pay a return on only those investments in properties that are used and useful in the public service.
>
> The argument that the security holders should be fully insulated from all risk in this matter is rejected. While a regulated utility may have a lesser degree of risk than unregulated companies that must compete for their markets, this is not to say that it is in the public interest to shield utility security holders from all risks, including the risk that management may initiate projects that do not become productive. This is a risk of any business.
>
> While it is clear that investors in utilities would prefer to have ratepayers absorb losses resulting from aborted projects, such preference does not constitute justification for casting the entire burden of such losses upon ratepayers.
>
> NEP's proposal to afford rate base treatment for the unrecovered portion of this expenditure is rejected.

NEPCO, 8 *FERC* (CCH) ¶ 61,054, at 61,175–76. Nothing in the *NEPCO* decision indicates that the Commission would act differently in a factually different case.

Similarly, this court's decision in *NEPCO* gave Jersey Central no reason to question the veracity of the Commission's *NEPCO* decision as establishing a substantive rule of ratemaking. The only question before us was "whether FERC's refusal to include project expenditures in the rate base, while allowing their recovery as costs over time, is a valid approach to allocating the risks of project cancellation." 668 F.2d at 1333. NEPCO complained that "[t]he sole ground for [the Commission's *NEPCO*] decision was that the expenditures for those facilities did not result in the operation of any used and useful plant." NEPCO Brief at 7. The Commission in turn defended its ruling in a justification of the used and useful rule. FERC Brief in *NEPCO* at 13–20. We held that FERC's approach was valid, without reference to the specific facts of the case, based solely on the Commission's consistent application of the used and useful doctrine. 668 F.2d at 1333–35. In rejecting NEPCO's *Hope* and takings arguments and upholding the Commission's treatment, we held that current ratepayers should bear only the legitimate costs of providing service to them; items not "used and useful" could not be included in the utility's rate base. *Id.* at 1333. Nothing in our opinion could lead Jersey Central to believe we would have found differently had its factual situation been before us.

Significantly, at one time Jersey Central conceded this very point. In appealing the decision of the New Jersey Board of Public Utilities (BPU) to disallow recovery of the carrying charges on the Forked River investment, Jersey Central acknowledged that the BPU decision was consistent with this court's decision in *NEPCO*. Excerpts from Brief on Behalf of Appellant Jersey Central Power and Light Company, before the Superior Court of New Jersey, Appellate Division, J.A. at 22 [hereinafter Excerpts from Jersey Central Brief]. In that proceeding, Jersey Central expended its energies in attacking the reasoning of our decision and in attempting to convince the court that it should encourage the BPU to

employ the "prudent investment" rate base formulation. Jersey Central was motivated by its belief that, unlike the used and useful formulation, the prudent investment approach would afford it the recovery it sought. *Id.*, J.A. at 22–26. Unsuccessful in its undertaking before the state court, Jersey Central apparently rethought the application of our *NEPCO* decision to its case. Its reconstruction does not hold up.

B. The Commission's Generalization of the *NEPCO* Rule

As the majority admits, at least four subsequent decisions laid down the same rule before Jersey Central filed its rates. Maj.Op. at 1184. In NEPCO's second attempt "to include in rate base the unamortized investment in abandoned generating projects," the Commission admonished that it had previously "clearly stated" that such inclusions were "improper." *New England Power Co.*, 16 FERC (CCH) ¶ 61,249, at 61,538 (Sept. 29, 1981) (citing *NEPCO* and summarily disposing of nonconforming portion of filing). In *Northern States Power Co.*, 17 FERC (CCH) ¶ 61,196 (Dec. 3, 1981), *aff'd sub nom. South Dakota Public Utilities Commission v. Federal Energy Regulatory Commission*, 690 F.2d 674 (8th Cir.1982), the Commission again held that the utility could not obtain a return on its lost investment. The case left no room for ambiguity; Jersey Central itself conceded that in *Northern States*, "FERC made clear that its intention was that the investors receive back their entire investment but be denied all return on that investment during the amortization period." Initial Brief of Jersey Central at 19. The Commission applied the *NEPCO* rule summarily, rejecting tariff filings that sought a return on investments not "used and useful."

In both *Ohio Edison Co.*, 18 FERC (CCH) ¶ 16,010 (Jan. 8, 1982), and *Central Maine Power Co.*, 18 FERC (CCH) ¶ 61,126 (Feb. 12, 1982), the agency cited *NEPCO* as its authority for the summary dispositions. These decisions thus clearly established a general rule of summary denial of non-conforming filings by the time Jersey Central made its initial filing in March 1982. *See Black Hills Power and Light Co.*, 19 FERC (CCH) ¶ 61,302, at 61,592 (June 24, 1982) (referring to rate base treatment of cancelled plants as "contrary to well-established precedent"); *see also Violet v. FERC*, 800 F.2d 280, 281 n. 2 (1st Cir.1986) (referring to NEPCO's 1982 agreement not to request reimbursement of the unamortized portion of its cancelled plant as "consistent with Commission policy") (citing *NEPCO*).

The majority belittles the import of these cases by brushing them off as "routine" and comparing them to Jersey Central's filing, which the majority characterizes as "anything but routine." Maj.Op. at 1184. This supposed distinction misses the mark. The Commission had established firm rate-making procedure—summary disposal of unamortized costs of cancelled plants included in electric utilities' rate base filings. The procedure did not vary with "factual differences," no matter how substantial. As to the critical fact, Jersey Central stood in exactly the same position as each other utility—it wanted rate base treatment of its abandoned investment. Jersey Central had no reason to think it would not receive identical treatment—summary refusal.

C. The Natural Gas Pipeline Cases

In a laborious attempt to show that the Commission had begun to waiver in its policy, or indeed was inviting

a utility to request the treatment that Jersey Central in fact sought, Jersey Central cites several gas pipeline cases. The utility maintains that it reasonably read the cases as suggesting a shift by the Commission away from the *NEPCO* rule. The majority agrees. Despite such distinguished ratification of Jersey Central's misreading of Commission precedents regarding gas pipelines, we find nothing in those cases to indicate any waivering by the Commission in its long-standing policy toward the cancelled construction projects of electric utilities.

Trailblazer Pipeline Company, 18 FERC (CCH) ¶ 61,244 (Mar. 12, 1982), the case upon which Jersey Central relies heavily and the majority relies exclusively, fails to validate Jersey Central's non-conforming rate filing. *Trailblazer* involved not a rate filing, but a preconstruction proceeding brought to obtain Commission certification of the appropriateness of the pipeline's financing. The Commission allowed the pipeline to recover debt service on an abandoned project because it was paid for through project financing, in which the stream of income generated by the project was the primary security for the loan. *See also Ozark Gas Transmission System*, 16 FERC (CCH) ¶ 16,099 (July 28, 1981) (approving recovery of actual debt interest for project paid for by project financing). It conditioned approval of inclusion of debt service in rate base "on applicants' waiver of their right to apply for the recovery of their equity investment in this project should it fail." 18 FERC ¶ 16,244, at 61,503.

The majority declares that *Trailblazer* "presented Jersey Central with some additional grounds for believing that the Commission would take a more flexible approach" in its case because the Commission had signalled its frustration with the disparate treatment given gas and electric companies. Maj.Op. at 1184. Yet the majority fails to substantiate the grounds for this belief. In its many permutations, the majority opinion has been unable to come up with an interpretation of *Trailblazer* that both supports Jersey Central's position and withstands scrutiny.

Trailblazer does not even announce a blanket rule allowing recovery of debt service and a return of, but not on, an investment by a natural gas company. It certainly does not hold that such a rule should or could be extended to electric utilities. More important, even if *Trailblazer* were read to control Jersey Central's filing, the utility would not recover the relief it seeks. In fact, the disparity between treatment of gas and electric cases identified in *Trailblazer* is that treatment of cancelled electric plants was *more* generous than treatment of cancelled gas facilities. The majority admits as much. *Id.* at 1185.

As was pointed out in the panel's first opinion in this case, the rule for gas companies would not permit Jersey Central to recover its equity investment, the debt, the carrying charges on the debt, and the preferred stock costs, all of which it attempted to do by including the Forked River investment in its rate base. Arguing that this understanding of *Trailblazer* is erroneous, the majority maintains that the Commission "suggest[ed]" that conventionally-financed pipelines would not have to waive their right to recover the equity investment in order to recover a return. *Id.* at 1185 n.6. We cannot locate any such suggestion in anything the Commission said. Indeed, any suggestion to be found is quite to the contrary.

In *dicta*, *Trailblazer* discussed the tariff that the Commission would consider if the pipeline opted for conventional rather than project financing. The Commission indicated that it would permit the applicant to "apply for recovery *of* the total investment in the project should it fail." 18 FERC (CCH) ¶ 61,244, at 61,504 (emphasis added). The Commission observed that the policy consideration of encouraging investment in prudent yet possibly risky projects pointed "in the direction of a consistent and more liberal allowance of abandoned plant costs in *cost of service*." *Id.* at 61,502 (referring to amortization of abandoned projects) (emphasis added). This observation, however, had no bearing on the Commission's policy of excluding a current return on an abandoned plant from the *rate base*. There is no suggestion that any utility should in addition receive a return *on* the equity portion of the investment. *See id.* at 61, 503 & n. 17. Indeed, the Commission expressed concern that even allowing a return *of* that investment creates too great an incentive for imprudent investments. *See id.* at 61,503 (stating that FERC's ratemaking procedures should "*not* promote investment in projects undertaken simply because the bill can be passed on to the ratepayers").

The majority misunderstands the ramifications of the Commission's assertion that there "is no obvious reason why the treatment of abandoned plant costs as between gas and electric companies should differ," *id.* at 61,511 n. 15. It was saying that in an appropriate natural gas case, one not paid for by project financing, amortization of abandoned plant costs should be allowed because it was already allowed in the electric company context. *See id.* (citing *NEPCO, supra, and Northern States Power Company supra); of Natural Gas Pipeline Co. v. Federal*

Energy Regulatory Commission, 765 F.2d 1155 (D.C.Cir. 1985) (establishing on its facts that a pipeline was not entitled to amortize its out-of-pocket expenses, to say nothing of its debt or carrying charges, for abandoned projects), *cert. denied*, ____ U.S. ____, 106 S.Ct. 794, 88 L.Ed.2d 771 (1968). Jersey Central has already benefited from this investment-fostering liberal approach. Unlike gas companies, Jersey Central was allowed to recover the expenditure made on its failed construction project.

The majority inexplicably seems to elevate Jersey Central's reliance on *Trailblazer's* supposed indication of the Commission's "flexibility" to a point of independent legal significance. *See* Maj.Op. at 1185 & n. 7. Regardless of the reasonableness of the company's expectation, one must query just how much Jersey Central "relied" upon *Trailblazer* in making its filing. In its initial brief to this court for review, the utility cited *Trailblazer* as additional support for its argument that the Commission should permit full amortization *and* a return on the debt and preferred portions of the unamortized amount. Initial Brief of Jersey Central at 20. However, it characterized the *Trailblazer* opinion as having been issued "shortly *after* Jersey's Central filing," *id.* at 8 (emphasis added), even though, as the majority notes, the opinion was published two weeks before the filing, Maj.Op. at 1185.

Whatever Jersey Central's intent, belief, or expectation, *Trailblazer* cannot carry the utility where it desperately wants to go, and where the majority is all too willing to usher it. *Trailblazer* never questions the continuing validity of the used and useful principle, which it would have to do to raise a reasonable doubt in Jersey Central's mind that the continuing validity of *NEPCO*

was open to question. We therefore conclude that summary disposition of Jersey Central's initial rate filing was appropriate under settled *NEPCO* used and useful doctrine. *See* 18 C.F.R. § 385.217 (1986) (summary disposition procedure). At the time Jersey Central filed its proposed rate revision, the requirement that the rate base exclude certain unallowable items had been upheld by this court; the Commission had stated its practice of applying this requirement; and the agency had not deviated from this position. Under these circumstances, the Commission properly rejected the non-conforming portion of Jersey Central's filing pursuant to its standard policy.

Petitioner stated at oral argument that in its proceeding before the Commission it set out to test the *NEPCO* doctrine. Everyone can appreciate Jersey Central's frustration with what it believed to be an unwise and ill-conceived rule. But the proper forum for challenging an agency rule is in a regulatory rulemaking proceeding, *not* in a ratemaking proceeding. *See generally* 1 K. Davis, *Administrative Law Treatise*, § 6:1 *et seq.* (1978). FERC is now, pursuant to a Notice of Inquiry, re-evaluating its entire approach to the regulation of wholesale electric requirements service. The agency intends to focus, in particular, on "the pricing and risk allocation policies," including its cancelled plant policy. *See* 31 FERC (CCH) ¶ 61,376 (June 28, 1985); *Regulation of Electricity Sales-for-Resale and Transmission Service*, 50 Fed.Reg. 27,604, at 67,612–14. (July 5, 1985). That is where Jersey Central should make its stand. The utility should not be allowed to convert a rate case into an involuntary rulemaking and manipulate this court into approving procedures FERC has rejected.

The majority puts this Notice of Inquiry to preposterous use. Although it buries its point in a footnote, the majority makes the remarkable assertion that the fact that the Commission has initiated this rulemaking proceeding "indicate[s]" that the agency had no "genuine rule with respect to the treatment of cancelled plants." Maj.Op. at 1185 n. 7. The fact that the Commission's regulatory policy with regard to electric utilities is evolving lends absolutely no support to the majority's and Jersey Central's contention that the agency had not established a firm rule in *NEPCO* and its progeny. An agency has every right, and indeed the responsibility, to reconsider and restructure its rules and policies when the circumstances warrant change. Regulatory policies are always in "a state of flux." *See id.* This evolution does not render the rules promulgated any less authoritative. Indeed, Congress has chosen to regulate through agencies in order to avoid the cumbersome, legislative process and to take advantage of agencies' ability to respond to everchanging industry practices and economic environments.

The Notice of Inquiry issued by the Commission cannot excuse the majority's willingness to second-guess the agency's policies. Courts have no place substituting themselves for agencies. Had Congress intended the courts to act as the supreme regulatory bodies, they would have made us subject to strictures, beyond Article III, that would preclude the freewheeling approach taken by the majority in its opinion today.

D. The Inappropriateness of Using Rate Base Calculation to Address Utilities' Financial Concerns

The infirmity of the majority's decision extends beyond its disregard for *NEPCO* as a rule of policy

regarding rate base calculation. Ratemaking is a complex process involving consideration of a myriad of factors. *See generally Regulation of Electricity Sales-for-Resale and Transmission Service*, 50 Fed.Reg. 27,604 (July 5, 1985) (discussing pricing and risk allocation policies toward electric utility requirements service). The more systematic the practice, the easier and more efficient the process can be for both the Commission and the individual utility. *See, e.g.*, 18 C.F.R. §§ 35 and 290 *et seq.* (1986) (outlining rules and procedures for filing of rate schedules and collection of cost of service information). If the majority's rationale is followed, items such as cancelled nuclear power plants will be included or excluded from utility rate bases dependent on the financial condition of the utility. Ad hoc rules for rate base composition invite a chaotic state of the law in a regulatory arena where certainty and predictability help ensure that just and reasonable rates are established.

Furthermore, rate base calculation is much too clumsy a tool for adjusting total return to accommodate the state of the utility's finances. Generally, the rate base is comprised of total capital invested in facilities minus depreciation plus cash working capital. The rate of return, on the other hand, is a weighted average of different rates applied to debt, preferred stock and common stock. Thus, the rate of return is the normal and most suitable vehicle for taking account of a given utility's fluctuating financial needs. Not surprisingly, as the Commission explained at oral argument, it is here that FERC does most of its "tinkering." *See* Maj.Op. at 1186–87. Indeed, it was through adjusting rate of return that FERC and Jersey Central settled their differences in this rate filing.

In addition, the majority's approach creates disincentives for a utility to operate efficiently. As the Commission observed, "[a] firm is more likely to work to minimize its costs if its financial health is at stake. . . . Thus, firms that bear significant business risk are more likely to produce efficiently than those [who] are sheltered from this risk." 50 Fed.Reg. at 27,612. Yet, under the majority's rationale not only are producers able to shift the risk of loss onto their ratepayers, but they are more likely to be able to do so if the loss is great and they are otherwise under financial strain. A healthy utility does not get its prudently incurred but cancelled expenditure included in its rate base, but a sickly utility does.

The Commission has expressed its concern that allowing recovery of the expenditure through amortization may reduce incentives for utilities to "avoid embarking upon questionable construction projects, or to stop work on partially constructed ones after their economic value has become unclear," or "to minimize construction costs." 50 Fed.Reg. at 27,614. If the company is more likely to recover not only its out-of-pocket costs but also a return on those costs if it is in financial decline, then the incentives for efficient production are reduced even further. And, as the concurrence points out, we are not dealing with small change. *See* Sep.Op. at 1188. The disincentives are large ones. Thus, the majority's method of treating rate base calculation frustrates the Commission's goal of "achiev[ing] the most efficient allocation of resources possible." *See Northern Natural Gas Co. v. FPC*, 399 F.2d 953, 959 (D.C.Cir. 1968).

The majority asserts that it is not insisting that Jersey Central receive the financial relief it seeks through a

rate base adjustment. *See* Maj.Op. at 1182 n. 5. The majority protests too much. Rate base treatment of Jersey Central's cancelled plant is, of course, the very thing at issue. The utility, as stated in its filing and as credited by the majority, has presented the rate package that it alleges will provide the minimum amount necessary to avoid nonconfiscatory rates; each element of the proposed rate structure is essential. Indeed, the majority argues, in response to our point that Jersey Central had other forms of relief open to it (other than inclusion of its cancelled plant in the rate base), that other alternatives would not meet the utility's specific financial needs. *See* Maj.Op. at 1186–87. The majority cannot have it both ways, and its refusal to accept the ramifications of its opinion in this regard reveals the extent to which it is blind to Jersey Central's real motivation—nullification of the *NEPCO* doctrine.

III. The Utility's Right to an Evidentiary Hearing

There may be times when the Commission cannot issue an interim summary disposition order even when based on a long-established settled rule. Jersey Central argues that this is such a time. It claims that the substantive policies and procedural filing requirements that the Commission established for recovery of abandoned power projects, whatever their merit for utilities facing less dire financial straits, were invalid as applied to Jersey Central's particular rate filing. The utility contends that the Commission's rate base requirements so jeopardized Jersey Central's financial integrity and long-term ability to attract capital that the Commission's order threatened to confiscate the capital that its owners had invested, in contravention of the *Hope* end

result test. Accordingly, it asserts that the Commission cannot summarily apply its *NEPCO* rule; rather, it must hold an evidentiary hearing concerning proper treatment of the utility's proposed rate base items. While acknowledging the electric utility industry's need to attract investors, we find that Jersey Central presents no valid reason why these concerns justify exemption from the Commission's clear requirements. The majority obviously disagrees. It is here that the majority opinion may cause the most confusion and caprice.

Ratemaking calls for "pragmatic adjustments" clearly within the province of the Commission, which "must be free . . . to devise methods of regulation capable of equitably reconciling diverse and conflicting interests." *Mobil Oil Corp. v. FPC*, 417 U.S. 283, 331, 94 S.Ct. 2328, 2356, 41 L.Ed.2d 72 (1974) (quoting *Permian Basin Area Rate Cases*, 390 U.S. 747, 767, 88 S.Ct. 1344, 1360, 20 L.Ed.2d 312 (1968)). The broad discretion the Commission enjoys in its ratemaking determinations, however, must be bridled in accordance with the statutory mandate that the resulting rates be "just and reasonable." In *Hope*, the Supreme Court articulated the standard by which a reviewing court examines a challenged rate. "Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling. . . . If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end." 320 U.S. at 602, 64 S.Ct. at 288 (citations omitted). Thus, *Hope* is a limit on judicial scrutiny, not a probing device for courts restless to enter the fray between utilities and the Commission on the actual rates to be approved.

Remarkably, the majority invokes *Hope* to direct the methods the Commission may employ in fashioning

Jersey Central's rates. Our colleagues accept Jersey Central's contention that "the Commission may not *summarily* exclude an investment from the rate base when the utility has alleged that its ability to attract capital will be seriously jeopardized as a result." Maj.Op. at 1172. They therefore conclude that the company is entitled to a hearing in order to have the opportunity to prove its allegations and demonstrate that the end result of the Commission's order—were it carried out—would violate the *Hope* standards. Regardless of the propriety of the Commission's used and useful policy, the majority holds that, given Jersey Central's allegations regarding its financial status, a hearing is required in order to implement this policy. To the contrary, we find nothing in Jersey Central's initial filing and its application for rehearing that demonstrates a need for a hearing at this stage of the proceeding.

Section 205 of the Federal Power Act, 16 U.S.C. § 824d(e) (1982), provides that "the Commission shall have authority . . . to enter upon a hearing" on the legality of a rate increase. This provision authorizes, but does not require, the Commission to conduct full-scale evidentiary hearings; the Commission may dispose of issues summarily if there is no need for a hearing. *See Cities of Batavia v. Federal Energy Regulatory Commission*, 672 F.2d 64, 91 (D.C. Cir.1982). In particular, a utility is not entitled to a hearing before the non-conforming portion of its rate filing is rejected, *see Southern California Edison Co. v. Federal Energy Regulatory Commission*, 686 F.2d 43, 47 (D.C.Cir.1982), or when it challanges an established policy. *See Papago Tribal Utility Authority v. Federal Energy Regulatory Commission*, 628 F.2d 235, 242 (D.C.Cir.), *cert. denied*, 449 U.S. 1061, 101 S.Ct. 784, 66 L.Ed.2d 604 (1980); *Municipal Light Boards v.*

FPC, 450 F.2d 1341, 1345–46 (D.C.Cir.1971); *see also* 3K. Davis, *Administrative Law Treatise* § 14.5 at 26–27 (1980) ("When a utility's entire filing consists of a legal challenge to well-entrenched policy, there is no need for the Commission to grant the challenger a hearing."). The Commission is under an obligation to grant a hearing only if the utility raises an "issue of adjudicative fact." *See United States v. Storer Broadcasting Co.*, 351 U.S. 192, 205, 76 S.Ct. 763, 771, 100 L.Ed. 1081 (1956); *Citizens for Allegan County, Inc. v. FPC*, 414 F.2d 1125 (D.C.Cir.1969).

Had Jersey Central raised a "serious *Hope* challenge," as the majority believes it did, Maj.Op. at 1178, there would be an issue of adjudicative fact which necessitates a hearing rather than summary disposition. The issue would be whether any action taken by the Commission to reduce the rates permitted Jersey Central would produce an unjust and unreasonable end result; that is, whether Jersey Central had proposed the "minimum" non-confiscatory rates possible. In summarily excluding the non-conforming costs from the rate base, the Commission impliedly determined that the utility had raised no issue of fact. Based on Jersey Central's allegations and the evidence before the Commission, we find this conclusion reasonable.

A. The Showing Necessary to Obtain a *Hope* Hearing

In order for Jersey Central to raise a serious *Hope* challenge, its allegations, if true, must suggest that the Commission's interim order—the exclusion of unamortized abandoned plant costs from the rate base—would result in unjust and unreasonable rates. According to the majority, Jersey Central has made the showing necessary to obtain a *Hope* hearing. Maj.Op. at 1169.

The majority is convinced by the utility's allegation that "the company has been shut off from long-term capital, is wholly dependent for short-term capital on a revolving credit arrangement that can be cancelled at any time, and has been unable to pay dividends for four years." *Id.* at 1181. This proffer simply echoes the investor interest described in *Hope*. See 320 U.S. at 603, 64 S.Ct. at 288, Maj.Op. at 1171–72. A utility must do more than recite the frustration of its stockholders' interests in order to obtain a *Hope* hearing. Thus, we cannot agree with the majority that "[t]he allegations made by Jersey Central and the testimony it offered track the standards of *Hope* and *Permian Basin* exactly." *See* Maj.Op. at 1178.

We need not adopt what the majority relentlessly maintains is FERC's interpretation of the required showing—"the order would put the utility into bankruptcy"—in order to reject the showing presented by Jersey Central. *See id.* at 1175, 1177, 1179, 1180. Nor need we decide what precise allegations and evidence would ultimately comprise the necessary showing. The court need only find, as we do, that Jersey Central's showing does not suffice. There are at least three types of showings which, in our view, are crucial to any attempt to obtain a *Hope* hearing at this intermediate stage of the rate proceeding and which are largely overlooked in the majority's opinion and absent from Jersey Central's filing.

1. The Nexus Between the Rate Order and the Utility's Financial Plight

It is axiomatic that FERC is not a guarantor of Jersey Central's financial health and that a utility may even go bankrupt for reasons beyond the regulator's

control. *See, e.g., Hope*, 320 U.S. at 603, 64 S.Ct. at 288. The Act and its constitutional limits ensure that the governmental ratemaking process does not "produce arbitrary or unreasonable consequences." *Permian Basin*, 390 U.S. at 800, 88 S.Ct. at 1377. They do not protect the utility from market forces. *Market Street Railway Co. v. Railroad Commission of California*, 324 U.S. 548, 567, 65 S.Ct. 770, 779, 89 L.Ed. 1171 (1945). Establishing a link between a utility's bad health and the actions of the regulator is thus essential to raising a viable *Hope* claim.

Jersey Central has not established this critical nexus. It simply complains that the government's ratemaking actions are the source of its problems; our colleagues never question this assumed causal connection. An examination of the evidence laid before FERC, however, leads us to doubt the validity of this assumption.

In its present financial circumstances, Jersey Central bears greater resemblance to the failing Market Street Railway Company than it does to the Hope Natural Gas Company, "which had advantage of an economic position which promised to yield what was held to be an excessive return on its investment and on its securities." *Market Street*, 324 U.S. at 566, 65 S.Ct. at 779 (finding investor considerations advanced in *Hope* "inapplicable to a company whose financial integrity already is hopelessly undermined"). Jersey Central had not been able to pay dividends for the four years prior to its filing; its access to capital had been hampered for about as long. Essentially, the utility is asking the Commission to relieve its economic miseries by approving dramatically increased rates. *See* Testimony of Dennis Baldassari, J.A. at 34 (testifying that the continuation of the present rate "will prolong the Company's inability to restore itself to a recognized level of credit worthi-

ness"); *compare Permian Basin*, 390 U.S. at 812, 88 S.Ct. at 1384 (noting that the rates proposed would "*maintain* the industry's credit and *continue* to attract capital") (emphasis added). Jersey Central's problems appear to stem largely from the operations of the free market, perhaps exacerbated by the actions of other regulators. FERC cannot be made responsible for curing those ills.

The Supreme Court has enunciated this principle quite frankly:

> The due process clause has been applied to prevent governmental destruction of existing economic values. It has not and cannot be applied to insure values or to restore values that have been lost by the operation of economic forces.

Market Street, 324 U.S. at 567, 65 S.Ct. at 780.

The entire electric utility industry faces a "financial crisis." *See* Excerpts from Jersey Central Brief, J.A. at 26 n. 19. As Baldassari remarked, the October 1973 oil embargo and the impact of inflation are problems generic to the industry. Testimony of Dennis Baldassari, J.A. at 33. Those utilities that invested heavily in nuclear facilities were particulary hard hit, not in the least by adverse public and political attitudes to nuclear power and its attendant dangers. *See id.* at 33–34. Any fair reading of Baldassari's testimony before FERC leads to the conclusion that economic forces, rather than any action on the part of FERC, have strapped Jersey Central into the financial straightjacket.

It should be noted that Jersey Central's investment portfolio places it in a uniquely tight predicament. Jersey Central is a subsidiary of the General Public Utilities Corporation, the electric utility that has among its

"prudent" investments the Metropolitan Edison Company and the infamous Three Mile Island (TMI) nuclear generating plant. Jersey Central intimates that the horrendous financial burden caused by the TMI-2 accident was the pivotal force in suspending construction of Forked River. *See id.* Presumably it also landed a heavy blow to Jersey Central's credit worthiness and financial integrity.

The market is not the only force potentially at work against Jersey Central. Many regulatory bodies have influence over Jersey Central's economic destiny; therefore, the utility must effectively link its financial distress to FERC. This showing is particularly important, since the federal government is responsible—on the whole—for the value of only about ten percent of electricity sales in the United States. The states regulate the major part of the utility business. As noted earlier, the New Jersey BPU has historically refused Jersey Central a return on unproductive facilities. *See* Excerpts from Jersey Central Brief, J.A. at 17 (blaming the company's financial woes on BPU's lack of rate relief). In addition, there are other federal agencies who share regulatory control with FERC. The Nuclear Regulatory Commission, for example, prohibited the company from starting up the unharmed TMI-1 generator, thereby severing the company's access to its prime source of desperately needed service and revenues.

If Jersey Central's problems derive from economic forces or from the actions of other regulatory bodies, then even FERC's full rate base treatment of the amounts at issue will not alter the company's inability to pay dividends or obtain long-term credit. At a minimum, a company claiming an unconstitutional taking

should have to show that FERC's actions caused or substantially contributed to the conditions alleged to be the result of the taking. Jersey Central has made no such showing. In fact, it appears as if the Commission's interim rate-reducing order is a small factor in the forces contributing to the utility's financial dilemma.

The majority takes the remarkable position that the Commission must alter its ratemaking procedures even if the utillity can only show that the Commission's action only affects "a minor portion of Jersey Central's business." Maj.Op. at 1182 n. 5. Such a position is untenable. From this perspective, the agency would be obliged to abandon its ratemaking procedures in every industry which experienced financial hardship, regardless of the principal causes of those conditions. Neither *Hope* nor the due process clause requires as much. *See Market Street*, 324 U.S. at 567, 65 S.Ct. at 779.

2. The Effects on Consumers

The burden is ultimately on Jersey Central to establish that the return allowed by FERC is constitutionally inadequate; part of the showing necessary to raise an issue of fact must include attention to the consumer interests which form an important part of the *Hope* balancing test. Under *Hope*, a taking occurs only when the agency has misbalanced the interests of investors and consumers. As the Court stated in *Permian Basin*,

> [t]he Commission cannot confine its inquiries [to the *Hope* investor criteria]; it is instead obliged at each step of its regulatory process to assess the requirements of the broad public interests entrusted to its protection by Congress. Accordingly, the "end result" of the Commission's orders must be measured as much by the success with which they

> protect those interests as by the effectiveness with which they "maintain . . . credit and . . . attract capital."

390 U.S. at 791, 88 S.Ct. at 1372.

The consumer interest essential to the just and reasonable balance is that of not being subjected to exploitative rates. The Commission stands as the watchdog providing "a complete, permanent and effective bond of protection from excessive rates and charges." *Id.* at 795, 88 S.Ct. at 1374 (quoting *Atlantic Refining Co. v. Public Service Commission*, 360 U.S. 378, 388, 79 S.Ct. 1246, 1253, 3 L.Ed.2d 1312 (1959)). Thus, this court has described utility consumers as the agency's "prime constituency." *See Maryland People's Counsel v. FERC*, 761 F.2d 780, 781 (D.C.Cir.1985) (citing *Hope*, 320 U.S. at 620, 64 S.Ct. at 296). The exact boundaries of an exorbitant rate are indeterminate. Ultimately, however, they must relate to the cost of service, *see Farmers Union Central Exchange, Inc. v. FERC*, 734 F.2d 1486, 1502 (D.C.Cir.) (citing *Hope*, 320 U.S. at 602–03, 64 S.Ct. at 287–88), *cert. denied sub nom., Williams Pipe Line Co. v. Farmers Union Central Exchange, Inc.*, 469 U.S. 1034, 105 S.Ct. 507, 83 L.Ed.2d 298 (1984), and the distribution of associated risk, *see Washington Gas Light Co. v. Baker*, 188 F.2d 11, 20 (D.C.Cir.1950).

Jersey Central argues that the agency has discriminated against its investors' interests, but it does not address how the Commission's balance weighed the consumer interests. More significantly, it does not show that paying more attention to its investors' interests would not exploit the consumer. *See* 18 C.F.R. § 35.13(e)(3)(1986)(stating that the utility has the burden of "establishing that the rate increase is just and

reasonable and not unduly discriminatory or preferential").

The majority is in seeming confusion as to the showing the company made with regard to protection of consumer interests. It states, without support, that "Jersey Central submitted figures and testimony to support its claim that . . . its proposed rates would not exploit consumers." Maj.Op. at 1180. Yet, in fact, Jersey Central itself never made this "claim"; it never broached the issue. The majority resurrects an unpersuasive argument in support of its contention—namely, that "the rates proposed in its filing would remain lower than those of neighboring utilities." *Id.* at 1181; *see Jersey Central Power & Light Co. v. FERC*, 768 F.2d 1500, 1502 (D.C. Cir.1985). Perhaps this point would lend support to the majority's assertion were there a competitive market for electricity service. But of course there is no competition in this market; electric utilities are natural monopolies subject to rate regulation. "What rates are 'just and reasonable' will in general depend on a utility's legitimate costs, and those costs can of course vary widely even among neighboring utilities. . . . That some utilities with monopoly markets adjacent to Jersey Central's are allowed to charge more than Jersey Central thus presumably signifies nothing more than that Jersey Central has access to cheaper sources of power, or for some other reasons has fewer legitimate costs." 768 F.2d at 1512 (Mikva, J., dissenting). It certainly does not show that Jersey Central's proposed rates would not exploit *its* customers.

The majority admits that "it is impossible for us to say at this juncture whether including the unamortized portion of Forked River in the rate base would exploit consumers *in this case*." Maj.Op at 1181. Since Jersey

Central alleges that its proposed rate schedule would yield the lowest nonconfiscatory rate possible, how can the majority then say that the company has made a *Hope* showing? Without a showing that its filing would *not* exploit consumers, Jersey Central has not presented allegations suggesting that the rate order does not meet the requirements of *Hope*. *Contra id.* at 1181. Absent such allegations, the utility is not entitled to a *Hope* hearing.

3. The Reasonableness of the Overall Return Allowed on the Forked River Project

Regardless of the formulation employed, the rates fixed by the Commission may not shift the risk of loss onto the consumer and then exact the practice of the loss from him in the event it occurs. Such a double taxing "would clearly violate the consumer interest against 'exorbitant' rates." *Washington Gas Light*, 188 F.2d at 20. Before questioning the application of the used and useful rule, therefore, it is important to discover if the investors in Forked River have already been compensated for the risk that the project would be cancelled before the investment in it was entirely recovered. *See id.* at 19–20.

The total return received by a utility is a function of both the rate base and the rate of return, and the total return on any given investment is a function of the allowable return over a period of time. Jersey Central has focused only on the "used and useful" method of rate base calculation with no attention to the rate of return, especially to the manner in which that return may arguably have already compensated its investors for the exclusion of the cancelled investment from the rate base. Without an explanation of the company's historic

allowed return, it is impossible to judge the reasonableness of the Commission's treatment of the Forked River plant.

In *Washington Gas Light*, the case so heavily relied upon by the majority, this court upheld a departure from the "used and useful" method of rate base calculation to the "prudent investment" approach. However, before approving the application of that formulation to the abandoned plant in that case, we remanded for further proceedings by the Commission. Contrary to the majority's explanation, we did not require findings concerning the "financial health" of the company. *See* Maj.Op. at 1177. A remand was necessary because Judge Bazelon realized that it was possible that the investors had already been compensated for the risk that the plant at issue would be abandoned. As Judge Bazelon observed, "[i]t seems likely . . . , in view of the prevalence in the past of the doctrine that abandoned property would not be included in the rate base (regardless of whether [rate orders] had resulted in complete recovery to the investor), that investors had been compensated for the risk of obsolescence." 188 F.2d at 20. Thus, it was possible that the rate of return allowed the company in earlier years—if properly calculated to reflect the risks of the utility business—would have compensated the company in advance for the risk that it would not obtain full rate base treatment of its investment later on. If the rate of return had served that risk compensation function, allowing additional recovery by switching rate base formulations midstream would overcompensate the utility and exploit the consumers. *Id.* at 19–20.

Jersey Central has made no allegations regarding the prior treatment of the Forked River plant in its ap-

proved rate of return. *Compare* Testimony of Dennis Baldassari, J.A. at 35 ("[T]he rates of return allowed in previous regulatory proceedings were never intended to compensate the investor for the risk of exposure to the costs of decontaminating TMI-2."). If Jersey Central has been compensated for the plant all along because its rate of return has historically been set in a world where one of the risks of being a utility is having an investment declared not to be "used and useful," then FERC has probably fulfilled its obligations under *Hope*.

In sum, in order to obtain a *Hope* hearing, Jersey Central must show that, due to the Commission's actions, it is in need of protection at this phase of the ratemaking process. That showing is conspicuously missing. Without it, the court has no business calling upon the Commission to alter its ratemaking procedures and provide a hearing at this interim stage. Once again, a protective device—the *Hope* end result test—is being used as a first strike weapon.

B. Limits of a "Just and Reasonable" Rate

In that Jersey Central is not entitled to a *Hope* hearing, it would normally be thought unnecessary to consider what the utility would have to prove, were it granted a hearing, in order to establish that the Commission's rates are confiscatory. The concurrence's attempt to analyze the evidence presented, while thoughtful, is premature. Because of breadth of the majority's opinion today, however, we are compelled to discuss the issue.

The real mischief of today's decision lies not in the majority's belief that the utility has raised an issue of fact necessitating a hearing, but in its determination that Jersey Central has actually made out a case of

constitutional confiscation. As Justice Douglas remarked, "he who would upset the rate order under the Act carries the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences." *Hope*, 320 U.S. at 602, 64 S.Ct. at 288. The majority believes that Jersey Central can meet this burden. We simply cannot swallow the majority's assertion that "it is probable that the facts alleged [by Jersey Central], if true, would establish an invasion of the company's rights." *See* Maj.Op. at 1169. In our view, it is beyond cavil that Jersey Central has not presented allegations which, if true, would establish that the Commission's orders result in unjust and unreasonable rates.

Despite the majority's seeming confidence, the precise contours of this required showing are unclear. The just and reasonable statutory standard is imprecise. As this court once explained, "the words themselves have no intrinsic meaning applicable alike to all situations." *City of Chicago v. FPC*, 458 F.2d 731, 750 (D.C.Cir.1971) (quoting *City of Detroit v. FPC*, 230 F.2d 810, 815 (D.C. Cir.1955)), *cert. denied*, 405 U.S. 1074, 92 S.Ct. 1495, 31 L.Ed.2d 808 (1972). Congress itself has provided no formula for determining an unjust and unreasonable rate. *Hope*, 320 U.S. at 600, 64 S.Ct. at 286. Cases subsequent to *Hope* have loosely defined this "deliberately broad" standard as drawing a "zone of reasonableness in which rates may properly fall. It is bounded at one end by the investor interest against confiscation and at the other by the consumer interest against exorbitant rates." *See, e.g., Washington Gas Light*, 188 F.2d at 15. Thus, the only way that a rate may fall outside the zone of reasonableness, from the utility's point of view, is if it is so low that it amounts to a unconstitutional taking under

the fifth amendment. *See FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 586, 62 S.Ct. 736, 743, 86 L.Ed. 1037 (1942).

Ascertaining what constitutes a taking in the rate regulatory context is difficult, in part because there is no deprivation of typical property interests, the conceptual cornerstone of takings law. The Supreme Court has repeatedly stressed that price fixing does not effect an uncompensated taking merely because investors are denied their expected return. Indeed, even in traditionally competitive industries, "loss of future profits—unaccompanied by any physical property restrictions—provides a slender reed upon which to rest a takings claim." *Andrus v. Allard*, 444 U.S. 51, 66, 100 S.Ct. 318, 327, 62 L.Ed.2d 210 (1979).

In *Permian Basin*, the Court restated the *Hope* doctrine as follows:

> Price control is "unconstitutional . . . if arbitrary, discriminatory, or demonstrably irrelevant to the policy the legislature is free to adopt. . . ." Nonetheless, the just and reasonable standard of the Natural Gas Act "coincides" with the applicable constitutional standards, and any rate selected by the Commission from the broad zone of reasonableness cannot be attacked as confiscatory.
>
> Accordingly, there can be no constitutional objection if the Commission, in its calculation of rates, takes fully into account the various interests which Congress has required it to reconcile.

390 U.S. at 769-70, 88 S.Ct. at 1361 (citations omitted).

Permian Basin teaches that if the Commission reasonably balances consumer and investor interests, then the resulting rate is *not* confiscatory. *Id.* at 770, 88 S.Ct. 1361. The separate opinion ably translates this into a

working definition of a confiscatory rate: it exists when "an unreasonable balance has been struck in the regulation process so as unreasonably to favor ratepayer interests at the substantial expense of investor interests." Sep.Op. at 1189. The majority appears to agree with the teaching of *Permian Basin*. *See* Maj.Op. at 1177–78. The lesson it gleans, however, is incongruous. According to the majority, balancing competing interests is not enough; a rate is confiscatory if it does not *satisfy* the "legitimate investor interest" outlined by the Court in *Hope*. Maj.Op. at 1177–78, 1180, 1181 n. 3, 1181–82 (insisting that the factors outlined in *Hope* describe a taking). This interpretation of *Hope* and *Permian Basin* is implausible.

The majority's assessment of Jersey Central's showing evinces a fundamental misunderstanding of the context in which the *Hope* Court discussed investor interests. It specified the interests at issue but did not require that rates fulfill them in order to be non-confiscatory. In *Hope*, the Court faced an assertion by the utility that the rates fixed by the Commission were so low as to be unjust and unreasonable. In testing this challenge, the Court essentially questioned whether the utility's shareholders had anything to complain about. The Court examined what was "important" "from the investor or company point of view" and found that the rate at issue fully satisfied any legitimate investor interest. 320 U.S. at 603, 64 S.Ct. at 288. Accordingly, the Court held that the rate could not be condemned from the investor viewpoint. *Id.* at 64 S.Ct. at 288, 289. One year later, Justice Jackson, speaking for a unanimous Court, refuted the majority's interpretation of the Court's holding in *Hope*: "All that was held was that a company could not complain if the return which was allowed made it

possible for the company to operate successfully." *Market Street*, 324 U.S. at 566, 65 S.Ct. at 779. The *Hope* Court did not define "unjust or unreasonable"; nor did it articulate when a rate would be confiscatory. It certainly did not hold that the end result could be condemned if the investor criteria defined in the case were not fulfilled. Indeed, it expressly noted that its holding made no suggestion that more or less might not be allowed. 320 U.S. at 603, 64 S.Ct. at 288; *see Market Street*, 324 U.S. at 566, 65 S.Ct. at 779.

This understanding of *Hope* is the only way to reconcile the Court's recitation of investor interests with its avowal that "regulation does not insure that the business shall produce net revenues." *See Hope*, 320 U.S. at 603, 64 S.Ct. at 288 (quoting *Natural Gas Pipeline*, 315 U.S. at 590, 62 S.Ct. at 745). Investor interests are only one factor in the assessment of constitutionally reasonable, therefore non-confiscatory, rates. *Permian Basin*, 390 U.S. at 769, 88 S.Ct. at 1361. In any instance, the rate must also "provide appropriate protection to the relevant public interests, both existing and foreseeable." *Id.* at 792, 88 S.Ct. at 1373. A just and reasonable rate which results from balancing these conflicting interests might not provide "enough revenue not only for operating expenses but also for the capital costs of the business . . . includ[ing] service on the debt and dividends on the stock." *See Hope*, 320 U.S. at 603, 64 S.Ct. at 288.

The Court made this abundantly clear in *Market Street*. The Commission rate order in *Market Street* was claimed to be confiscatory. 324 U.S. at 562, 65 S.Ct. at 777. Like Jersey Central, the complaining company asserted that *Hope* "entitled [it] to a return 'sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital'

and to 'enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed.' " *Id.* at 566, 65 S.Ct. at 779 (quoting *Hope*, 320 U.S. at 603, 605, 64 S.Ct. at 288, 289). The Court dismissed the argument out of hand. In approving a rate that concededly consigned the company to operating at a loss, the Court made clear that a just and reasonable rate might not satisfy the investor "considerations" expounded in *Hope*. At the very least, the Court revealed that the *Hope* test does not guarantee rates that are fixed to provide a return "on an investment after it has vanished, even if once prudently made, or to maintain the credit of a concern whose securities already are impaired." *Id.* at 567, 65 S.Ct. at 780.

Neither the regulatory process nor the fifth amendment shelter a utility from market forces. *See id.* Thus, contrary to the majority's intimations, rates do not fall outside the zone of reasonableness merely because they do not enable the company to operate at a profit or do not permit investors to recover all their losses.

The zone of reasonableness can be viewed as circumscribing the appropriate allocation of costs and benefits in the regulatory context. In an unregulated environment, the customer would not be deemed a risk-taker. He invests no capital in the enterprise and therefore bears neither the upside nor the downside risk. The investors are the risk-takers. Under price regulations, which affords the utility a "natural monopoly" on service, some of the risk at either end of the spectrum is shifted onto the ratepayer. The transfer, however, is not so dramatic as to relieve the stockholder of the entire risk of loss.

Application of this principle is readily apparent in the Commission's current treatment of electric utility plants, investments prudent when made but sometimes frustrated in fruition. If the investment is successful, the customer benefits from controlled rates for the service provided. But the ratepayer also shares the costs if the investment fails; he must pay for the expenditure made on an unproductive facility from which he obtains no service. From the investor's viewpoint, price regulation cabins both his upside and downside risk. He cannot collect the windfall benefits if the project is a boon; he does not bear all costs if the project is a bust. Electric utility stockholders do not lose equity in the nonserviceable facility, as they might in the marketplace. They simply do not procure a return on the investment.

The majority quibbles with this risk allocation; it would prefer a world in which the investor is guaranteed a return on his investment, if prudent when made. *See* Maj.Op. at 1180–81 & n. 2. Its resultant holding today is directly at odds with fundamental principles laid out in *Hope* and its progeny. Adherence to the majority's insistance on the inclusion of prudent investments in the rate base would virtually insulate investors in public utilities from the risks involved in free market business. *See* Sep.Op. at 1190. This would drastically diminish protection of the public interest by thrusting the entire risk of a failed investment onto the ratepayers. *See id.* at 1190. Jersey Central and the majority would convert utility stockholders from risk-takers into annuity holders. *See* Excerpts from Jersey Central Brief, J.A. at 18 (analogizing its suggested "cost-sharing" to a levelized mortgage or annuity). Neither *Hope* nor the fifth amendment takings clause sanctions such radical results. *Cf. Hope*, 320 U.S. at 603,

64 S.Ct. at 288 (stating that the "return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks").

In any event, this court should not ordain the drastic risk shifting that Jersey Central advocates in its filing. The proper allocation of risk between shareholders and ratepayers is a serious ongoing question. *See supra* page 1202. It raises cross-cutting issues too broad to be ventilated in a single rate proceeding. "The importance of this issue . . . transcends the impact on a single jurisdictional utility." *New England Power Co.*, 32 FERC (CCH) ¶ 61,453, at 62,042 (Sept. 30, 1985). The majority's conclusion that the allocation reached by the Commission may be unconstitutional on the facts alleged has serious and troubling implications, especially for the twenty-five states that currently exclude cancelled facility expenses from a utility's rate base.

IV. Hearing on the Altered Rate Filing

As we have indicated, the Commission reasonably applied its settled rate base filing rule to Jersey Central according to its established summary disposition procedures. Nothing in Jersey Central's allegations automatically entitled it to a hearing. The utility was entitled to, and was afforded, a hearing on its proposed rate of return on the conforming items in its rate base. Jersey Central nevertheless makes one additional complaint against the Commission. In its final challenge, Jersey Central objects to the Commission's refusal to entertain the utility's attempt to inflate the rate of return proffered in its initial filing. This is yet another move by Jersey Central designed to convince this court to endorse its skirting of valid agency procedures.

In rejecting Jersey Central's plea, the Commission invoked its long-standing rule that "utilities may not present a 'moving target' by offering alternative justifications for previously filed rates." 20 FERC (CCH) ¶ 61,108, at 61,182. As this court noted in its original opinion, this rule is not arbitrary. It is justified by the "administrative necessity of closing the books at a time certain," as well as the need for a "mechanism to prevent utilities from delaying refund orders by offering alternative justifications for the rate increases [they have] filed. FPC staff and intervenors cannot be expected to follow a moving target." *New England Power Co. v. FPC*, No. 75-1379, slip op. at 3 (1st Cir. Nov. 13, 1975), *cited* in 20 FERC (CCH) ¶ 61,108, at 61,182.

The majority never questions the Commission's authority to implement this rule. Rather, it questions the appropriateness of its application in Jersey Central's case. The majority seems to believe that the Commission's refusal to grant a hearing on the higher rate of return stripped petitioner of any chance to plead its case and obtain the rates it desired. Despite the majority's protestations to the contrary, Jersey Central had sufficient opportunities to seek the revenues it requested. We are therefore unpersuaded by the utility's contention that it was denied a fair hearing.

As noted at the outset, the utility had at least two separate opportunities to raise its concerns and to request the full rate increase anticipated by its rejected filing. Either approach would have raised an issue of fact, precluding summary disposition. First, Jersey Central could have filed *initially* for a higher rate of return on its used and useful property, or for a shorter amortization period on its Forked River investment. Because a shorter amortization period would allow the utility to

recover its investment sooner, it would have had the same effect of increasing total return as did Jersey Central's attempt, flatly contradicted by the clear precedent in *NEPCO* and later cases, to increase the size of the rate base. Indeed, Jersey Central concedes this point. If the utility had followed *NEPCO*, and supported its proposed rate increase by filing for amortization of its investment in cancelled projects over five years instead of fifteen, rates higher than those it initially proposed would have been justified.

Second, Jersey Central could have made the same requests by *refiling* its rates, using a proper rate base. This new filing, of course, could not have stood alone without supporting exhibits and affidavits. As the Commission observed, "the company's [initial] case-in-chief did not include testimony seeking to support a return other than 19% based on any alternative scenario of events, including summary disposition of rate base items." 20 FERC (CCH) ¶ 61,108, at 61,182. In order to recover a higher return, petitioner would be required to offer cost and market data at the time of their filing that would support that rate of return. *See* 18 C.F.R. § 35.13(e) (1986) (testimony and exhibits supporting filing of changes in rate schedules).

Where the majority reads "in the [rehearing denial] order [that] the Commission made it clear a fresh filing would be futile" escapes comprehension. *See* Maj.Op. at 1187. The utility certainly did not get that message. The following exchange from *en banc* oral argument amplifies Jersey Central's recognition that it was free to submit a new rate filing and thereby obtain a hearing:

> COURT: But you could have put in a new filing, couldn't you?

> COUNSEL: We could have, sir, but . . .
>
> COURT: At any time, even now?
>
> COUNSEL: [W]e could but we believed then and we believe today that that precedent was wrong and we would not have had an opportunity to—
>
> COURT: That is really what I wanted to clear up. Your concern really is you strongly disagree with the *NEPCO* precedent—
>
> COUNSEL: Yes, we do, sir.
>
> COURT: —I understand that, but as far as you are concerned the use of the useful rule as applied in *NEPCO* is a bad idea and you would like this Court to change its mind.
>
> COUNSEL: Yes, sir, no question about it.

Tr. at 8.

As an alternative to submitting a different rate filing, Jersey Central could have asked for an individualized exemption from the *NEPCO* rule. The Commission's filing requirements provide that "[i]f any filing does not comply with any applicable statute, rule, or order, the filing may be rejected, unless the filing is accompanied by a motion requesting a waiver of the applicable requirement of a rule or order and the motion is granted." 18 C.F.R. § 385.2001(b)(1) (1986). By providing this waiver process, the Commission exercises its inherent power to relax, modify, or waive its filing requirements. *See Papago Tribal Utility Authority*, 628 F.2d at 247; *Municipal Electric Utility Association v. Federal Power Commission*, 485 F.2d 967, 975 n. 28 (D.C.Cir. 1973). Jersey Central did not move for such an exemption.

As its responses at oral argument illustrate, Jersey Central declined these multiple opportunities because it wanted to challenge the *NEPCO* rule directly, and none of

the permissible options allowed it to do so. The hearing it would have obtained had it made a new filing would not have enabled it to address the *NEPCO* doctrine; nor would the filing of a complying tariff in the first instance have provided that vantage. Similarly, merely asking for an exemption would in no way threaten the viability of the doctrine. The majority demonstrates that such a "characterization" of the utility's filings would be "an unreasonable one," Maj.Op. at 1185, but no characterization is necessary. Jersey Central plainly stated its purpose and acted upon it.

Jersey Central could have sought review of what it perceives as an unsound rule without trampling on the Commission's filing policies and procedures and without asking this court to become involved. It could have petitioned the Commission for a rulemaking. NEPCO took this approach in its 1985 submission for filing of a proposed rate increase. *See New England Power Co.*, 32 FERC (CCH) ¶ 61,454 (Sept. 30, 1985) (Phase II). NEPCO "request[ed] that the Commission reexamine its policy regarding the treatment of the costs of cancelled plant." *Id.* at 62,042 (citing *NEPCO*). Unlike Jersey Central, however, NEPCO did not factor its suggested treatment of abandoned plants into the rates it proposed; rather, it sought only a prospective change in the policy. *Id.* at 62,043 n. 5. In this way, the Commission was able to begin reexamining *NEPCO* "as well as the economic and legal underpinnings for a cancelled plant policy" in the rulemaking context. *Id.* at 62,042; *see also Pennsylvania Electric Co.*, 34 FERC (CCH) ¶ 61,141, 61,244 n. 8 (Feb. 4, 1986) ("[A]ny change in Commission policy would be prospective only, and utilities are required to adhere to the precedent established in [*NEPCO*] pending reconsideration of our policy."); *New England Power Co.*, 35 FERC (CCH) ¶ 61,353 (June 18, 1986) (denying motion to limit generic scope of NEPCO Phase II hearing).

In light of these opportunities, deliberately avoided, we cannot question the reasonableness of the Commission's application of its rule against presenting a "moving target." Of course, we do not suggest that an agency may implement any policy through any procedure, no matter how unreasonable, and compel the applicant to adhere to them in order to preserve its right to seek relief from the agency. We find only that the Commission acted validly in requiring Jersey Central to follow reasonable policy and filing requirements. The measure of their reasonableness is that they afforded Jersey Central ample opportunity to contend that, taking its balance sheet and troubled history of investments into account, the total return it requested was just and reasonable. They also provided the company with a platform for advocating the discontinued application of the used and useful doctrine to cancelled electric utility facilities. Given these opportunities, Jersey Central cannot seek from this court the relief and the individualized attention to its financial plight that it could have obtained from the Commission.

Conclusion

This is a case of modest proportions about one segment of the sweeping ratemaking responsibilities that Congress has entrusted to the Commission. Like all arms of the government, the agency must abide by its statutes and by the constitutional prohibition against taking property without due process of law. But the due process claims of a regulated utility are not coupons which can be exchanged for a hearing at a time, place,

and manner of the utility's choosing. Such an approach would wreak havoc with the agency's ability to administer a complex rate regulation system that must assess many rate filings annually.

There may indeed be times when the Commission is not free to employ the used and useful principle in a summary fashion. However, Jersey Central has not made the case for its exception. Its allegations do not raise a question of fact sufficient to trigger a *Hope* hearing before application of well-settled, court-approved ratemaking procedure and policy. The concerns about financial integrity and investor return that Jersey Central held in reserve for a hearing challenging the NEPCO rule should have been raised by following the Commission's established rules and procedures. We express no view on substantive rate-base requirements that may come before this court in another case; we find only that on these facts the Commission was not obligated to hold a hearing before entering its interim rate-reducing order. The Commission's administrative processes offered ample opportunities for Jersey Central to request and present supporting evidence for whichever rate of return and amortization period the utility deemed necessary to preserve its financial integrity, and to seek review of the *NEPCO* doctrine. Jersey Central chose not to avail itself of these opportunities, and now cries foul.

There is, in the end, only one reason that Jersey Central wants its hearing *before* the unamortized portion of its unproductive investment is excluded from the rate base. That timing is the only means it perceives as enabling it both to launch its frontal attack on the Commission's *NEPCO* doctrine and to immediately reap the rewards of any victory in the battle. The majority's

sympathy for Jersey Central appears driven by its agreement that the used and useful doctrine is outdated and should be replaced with a pure prudent investment approach. *See* Maj.Op. at 1175, 1180–81 & n. 2. By granting a hearing to Jersey Central at this stage of the long and complex ratemaking process, the majority provides the utility a forum in which to argue its causes. But it also interferes with the Commission's discretion in implementing ratemaking policies and procedures. It thereby threatens the well-held maxim that the Commission is "not bound to use any single formula or combination of formulae in determining rates." *See Hope*, 320 U.S. at 602, 64 S.Ct. at 287.

In an era of heightened deference to administrative decisions and procedures, this court especially ought to be sensitive to the line between legitimate judicial review and judicial substitutions for agency processes. *See Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984); *Vermont Yankee, supra.* The majority has reordered the very filing procedures that FERC may prescribe, has redirected the kinds of hearings in which FERC may consider changes in its policies and, worst of all, has thrust the courts back into the very complicated forest of making the rates that regulated industries may charge. We ignore at our peril the hard-learned lessons of restraint expressed by the Supreme Court in *Natural Gas Pipeline* and *Hope*. The majority would have us relive that painful period.

APPENDIX L

Excerpts from the Pennsylvania Public Utility Code

CHAPTER 13
RATES AND RATE MAKING

Sec.

1301. Rates to be just and reasonable.
1302. Tariffs; filing and inspection.
1303. Adherence to tariffs.
1304. Discrimination in rates.
1305. Advance payment of rates; interest on deposits.
1306. Apportionment of joint rates.
1307. Sliding scale of rates; adjustments.
1308. Voluntary changes in rates.
1309. Rates fixed on complaint; investigation of costs of production.
1310. Temporary rates.
1311. Valuation of and return on the property of a public utility.
1312. Refunds.
1313. Price upon resale of public utility services.
1314. Limitation on prices paid for property and fuel.
1315. Limitation on consideration of certain costs for electric utilities.
1316. Recovery of advertising expenses.
1316.1. Recovery of club dues.
1317. Regulation of natural gas costs.
1318. Determination of just and reasonable natural gas rates.
1319. Financing of energy supply alternatives.
1320. Fuel purchase audits by complaint.
1321. Recovery of certain employee meeting expenses.
1322. Outages of electric generating units.
1323. Procedures for new electric generating capacity.
1324. Residential telephone service rates based on duration on distance of call.
1325. Local exchange service increases; limitation.

Enactment. Chapter 13 was added July 1, 1978, P.L.598, No. 116, effective in 60 days.

§ 1301. Rates to be just and reasonable.

Every rate made, demanded, or received by any public utility, or by any two or more public utilities jointly, shall be just and reasonable, and in conformity with regulations or orders of the commission. Only public utility service being furnished or rendered by a municipal corporation, or by the operating agencies of any municipal corporation, beyond its corporate limits, shall be subject to regulation and control by the commission as to rates, with the same force, and in like manner, as if such service were rendered by a public utility.

§ 1302. Tariffs; filing and inspection.

Under such regulations as the commission may prescribe, every public utility shall file with the commission, within such time and in such form as the commission may designate, tariffs showing all rates established by it and collected or enforced, or to be collected or enforced, within the jurisdiction of the commission. The tariffs of any public utility also subject to the jurisdiction of a Federal regulatory body shall correspond, so far as practicable, to the form of those prescribed by such Federal regulatory body. Every public utility shall keep copies of such tariffs open to public inspection under such rules and regulations as the commission may prescribe. One copy of any rate filing shall be made available, at a convenient location and for a reasonable length of time within each of the utilities' service areas, for inspection and study by customers, upon request to the utility.

(Dec. 21, 1984, P.L.1265, No.240, eff. imd.)

§ 1303. Adherence to tariffs.

No public utility shall, directly or indirectly, by any device whatsoever, or in anywise, demand or receive from any person, corporation, or municipal corporation a greater or less rate for any service rendered or to be rendered by such public utility than that specified in the tariffs of such public utility applicable thereto. The rates specified in such tariffs shall be the lawful rates of such public utility until changed, as provided in this part. Any public utility, having more than one rate applicable to service rendered to a patron, shall, after notice of service conditions, compute bills under the rate most advantageous to the patron.

§ 1304. Discrimination in rates.

No public utility shall, as to rates, make or grant any unreasonable preference or advantage to any person, corporation, or municipal corporation, or subject any person, corporation, or municipal corporation to any unreasonable prejudice or disadvantage. No public utility shall establish or maintain any unreasonable difference as to rates, either as between localities or as between classes of service. Unless specifically authorized by the commission, no public utility shall make, demand, or receive any greater rate in the aggregate for the transportation of passengers or property of the same class, or for the transmission of any message or conversation for a shorter than for a longer distance over the same line or route in the same direction, the shorter being included within the longer distance, or any greater rate as a through rate than the aggregate of the intermediate rates. This section does not prohibit the establishment of reasonable zone or group systems, or classifications of rates or, in the case of common car-

riers, the issuance of excursion, commutation, or other special tickets at special rates, or the granting of non-transferable free passes, or passes at a discount to any officer, employee, or pensioner of such common carrier. No rate charged by a municipality for any public utility service rendered or furnished beyond its corporate limits shall be considered unjustly discriminatory solely by reason of the fact that a different rate is charged for a similar service within its corporate limits.

§ 1305. Advance payment of rates; interest on deposits.

No public utility shall require the payment of rates in advance, or the making of minimum payments, ready to serve charges, or deposits to secure future payments of rates, except as the commission, by regulation or order, may permit. Any deposit made by any domestic consumer, under the provisions of this section or under any repealed statute supplied by this part, shall be returned with any interest due thereon to the consumer making such deposit when he shall have paid undisputed bills for service over a period of 12 consecutive months.

§ 1306. Apportionment of joint rates.

Where public utilities entitled to share in any joint rate shall be unable to agree upon the division thereof, or shall make any unjust or unreasonable division or apportionment thereof, the commission may, after hearing, upon its own motion or upon complaint, fix the proportion to which each public utility shall be entitled.

§ 1307. Sliding scale of rates; adjustments.

(a) General rule.—Any public utility, except common carriers and those natural gas distributors with gross intrastate annual operating revenues in excess of

$40,000,000 with respect to the gas costs of such natural gas distributors, may establish a sliding scale of rates or such other method for the automatic adjustment of the rates of the public utility as shall provide a just and reasonable return on the rate base of such public utility, to be determined upon such equitable or reasonable basis as shall provide such fair return. A tariff showing the scale of rates under such arrangement shall first be filed with the commission, and such tariff, and each rate set out therein, approved by it. The commission may revoke its approval at any time and fix other rates for any such public utility if, after notice and hearing, the commission finds the existing rates unjust or unreasonable.

(b) Mandatory system for automatic adjustment.—The commission, by regulation or order, upon reasonable notice and after hearing, may prescribe for any class of public utilities, except common carriers and those natural gas distributors with gross intrastate annual operating revenues in excess of $40,000,000, a mandatory system for the automatic adjustment of their rates, by means of a sliding scale of rates or other method, on the same basis as provided in subsection (a), to become effective when and in the manner prescribed in such regulation or order. Every such public utility shall, within such time as shall be prescribed by the commission, file tariffs showing the rates established in accordance with such regulation or order.

(c) Fuel cost adjustment.—In any method automatically adjusting rates to reflect changes in fossil fuel cost under this section, the fuel cost used in computing the adjustment shall be limited, in the case of an electric utility, to the cost of such fuel delivered to the utili-

ty at the generating site at which it is to be consumed, and the cost of disposing of solid waste from scrubbers or other devices designed so that the consumption of Pennsylvania-mined coal at the generating site would comply with the sulfur oxide emission standards prescribed by the Commonwealth. The cost of fuel handling after such delivery, or of waste disposal, other than as prescribed in this section, shall be excluded from such computation. In any method automatically adjusting rates to reflect changes in fuel cost other than fossil fuel cost under this section, the fuel cost used in computing the adjustment shall be limited, in the case of an electric utility, to the cost of such fuel delivered to the utility at the generating site at which it is to be consumed after deducting therefrom the present salvage or reuse value of such fuel, as shall be established by commission rule or order.

(d) Fuel cost adjustment audits.—The commission shall conduct or cause to be conducted, at such times as it may order, but at least annually, an audit of each public utility which, by any method described in this section, automatically adjusts its rates to reflect changes in its fuel costs, which audit shall enable the commission to determine the propriety and correctness of amounts billed and collected under this section. Whoever performs the audit shall be a person knowledgable in the subject matter encompassed within the operation of the automatic adjustment clause. The auditors report shall be in a form and manner directed by the commission.

(e) Automatic adjustment reports and proceedings.—

(1) Within 30 days following the end of such 12-month period as the commission shall designate, each public utility using an automatic adjustment

clause shall file with the commission a statement which shall specify for such period:

(i) the total revenues received pursuant to the automatic adjustment clause;

(ii) the total amount of that expense or class or expenses incurred which is the basis of the automatic adjustment clause; and

(iii) the difference between the amounts specified by subparagraphs (i) and (ii).

Such report shall be a matter of public record and copies thereof shall be made available to any person upon request to the commission.

(2) Within 60 days following the submission of such report by a public utility, the commission shall hold a public hearing on the substance of the report and any matters pertaining to the use by such public utility of such automatic adjustment clause in the preceding period and may include the present and subsequent period.

(3) Absent good reason being shown to the contrary, the commission shall, within 60 days following such hearing, by order direct each such public utility to, over an appropriate 12-month period, refund to its patrons an amount equal to that by which its revenues received pursuant to such automatic adjustment clause exceeded the amount of such expense or class of expenses, or recover from its patrons an amount equal to that by which such expense or class of expenses exceeded the revenues received pursuant to such automatic adjustment clause.

(4) For the purpose of this subsection, where a 12-month report period and 12-month refund or recovery period shall have been previously established or designated, nothing in this section shall impair the continued use of such previously estab-

lished or designated periods nor shall anything in this section prevent the commission from amending at any time any method used by any utility in automatically adjusting its rates, so as to provide the commission more adequate supervision of the administration by a utility of such method and to decrease the likelihood of collection by a utility, in subsequent periods, of amounts greater or less than that to which it is entitled, or, in the event that such deficiency or surplus in collected amounts is found, more prompt readjustment thereof.

(f) Recovery of natural gas costs.—

(1) Natural gas distributors with gross intrastate annual operating revenues in excess of $40,000,000 may file tariffs reflecting increases or decreases in their natural gas costs and the tariffs shall have an effective date six months from the date of filing. The commission shall promulgate regulations establishing the time and manner of such filing, but no such natural gas utility shall voluntarily file more than one such tariff in a 12-month period: Provided, That nothing contained herein shall prohibit any party from advising the commission that there has been or there is anticipated to be a significant difference between the natural gas costs to the utility and the costs reflected in the then effective tariff or the commission from acting upon such advice.

(2) The commission shall hold a hearing or hearings, with notice, to investigate the tariffs. Where there has been an indication of consumer interest, the hearing shall be held in the service territory of the natural gas distributor. Prior to the effective date of the filing, the commission shall issue an order establishing the rate to be charged to reflect such increases or decreases in natural gas costs. Rates established under this subsection do not constitute either a sliding scale of rates or an automatic adjustment subject to the prohibitions in subsections (a) and (b). Such rates, however, are subject to the same kinds of audits, reports and proceedings required by subsection (d).

(3) Within 60 days following the end of such 12-month period as the commission shall designate, each public utility subject to this subsection shall file with the commission a statement which specifies for such period:

(i) The total revenues received pursuant to this section.

(ii) The total gas expense incurred.

(iii) The difference between the amounts specified by subparagraphs (i) and (ii).

(iv) Evidence explaining how actual costs incurred differ from the costs allowed under paragraph (2) and why such differences occurred.

(v) How these costs are consistent with a least cost procurement policy as required by section 1318 (relating to determination of just and reasonable natural gas rates).

Such report shall be a matter of public record and copies thereof shall be made available by the gas distributor to any person upon request. Copies of the reports shall be filed with the Office of Consumer Advocate at the same time as they are filed with the commission.

(4) The commission shall hold a public hearing on the substance of such statement submitted by a utility as required in paragraph (3) and on any related matters.

(5) The commission, after hearing, shall determine the portion of the companies' actual gas costs in the previous 12-month period which meet the standards set out in section 1318. The commission

shall, by order, direct each gas utility subject to this subsection to refund to its patrons any gas revenues collected pursuant to paragraph (2) which exceed the amount of actual gas expenses incurred consistent with the standards in section 1318 and to recover from its patrons any amount by which the actual gas expenses, which have been incurred consistent with the standards in section 1318, exceed the revenues collected pursuant to paragraph (2). Absent good reason to the contrary, the commission shall issue its order within six months following the filing of the statement described in paragraph (3). Refunds to patrons shall be made with interest, which shall be the average rate of interest specified for residential mortgage lending by the Secretary of Banking in accordance with the act of January 30, 1974 (P.L.13, No.6), referred to as the Loan Interest and Protection Law, during the period or periods for which the commission orders refunds: Provided, That nothing contained herein shall limit the applicability of any defenses, principles or doctrines which would prohibit the commission's inquiry into any matters that were decided finally in the commission's order issued under paragraph (2).

(g) Definition.—As used in this section the term "natural gas" includes natural gas, liquified natural gas, synthetic natural gas and any natural gas substitutes.

(May 31, 1984, P.L.370, No.74, eff. 60 days; Sept. 27, 1984, P.L.721, No.153, eff. 60 days; Dec. 21, 1984, P.L.1265, No.240, eff. imd.)

1984 Amendments. Act 74 amended subsecs. (a) and (b) and added subsecs. (f) and (g), Act 153 amended subsec. (a) and Act 240 amended subsecs. (a) and (f). The amendments by Acts 153 and 240 to subsec. (a) are identical. See section 5 of Act 74 and section 7 of Act 240 in the appendix to this title for special provisions relating to applicability.

Cross References. Section 1307 is referred to in sections 1317, 1318 of this title.

§ 1308. Voluntary changes in rates.

(a) General rule.—Unless the commission otherwise orders, no public utility shall make any change in any existing and duly established rate, except after 60 days notice to the commission, which notice shall plainly state the changes proposed to be made in the rates then in force, and the time when the changed rates will go into effect. The public utility shall also give such notice of the proposed changes to other interested persons as the commission in its discretion may direct. Such notices regarding the proposed changes which are provided to the utility's customers shall be in plain understandable language as the commission shall prescribe. All proposed changes shall be shown by filing new tariffs, or supplements to existing tariffs filed and in force at the time. The commission, for good cause shown, may allow changes in rates, without requiring the 60 days notice, under such conditions as it may prescribe.

(b) Hearing and suspension of rate change.—Whenever there is filed with the commission by any public utility any tariff stating a new rate, the commission may, either upon complaint or upon its own motion, upon reasonable notice, enter upon a hearing concerning the lawfulness of such rate, and pending such hearing and the decision thereon, the commission, upon filing with such tariff and delivering to the public utility affected thereby a statement in writing of its reasons therefor, may, at any time before it becomes effective, suspend the operation of such rate for a period not longer than six months from the time such rate would otherwise become effective, and an additional period of

not more than three months pending such decision. The rate in force when the tariff stating the new rate was filed shall continue in force during the period of suspension, unless the commission shall establish a temporary rate as authorized in section 1310 (relating to temporary rates). The commission shall consider the effect of such suspension in finally determining and prescribing the rates to be thereafter charged and collected by such public utility. This subsection shall not apply to any tariff stating a new rate which constitutes a general rate increase as defined in subsection (d).

(c) Determination.—If, after such hearing, the commission finds any such rate to be unjust or unreasonable, or in anywise in violation of law, the commission shall determine the just and reasonable rate to be charged or applied by the public utility for the service in question, and shall fix the same by order to be served upon the public utility and such rate shall thereafter be observed until changed as provided by this part.

(d) General rate increases.—Whenever there is filed with the commission by any public utility described in paragraph (1)(i), (ii), (vi) or (vii) of the definition of "public utility" in section 102 (relating to definitions), and such other public utility as the commission may by rule or regulation direct, any tariff stating a new rate which constitutes a general rate increase, the commission shall promptly enter into an investigation and analysis of said tariff filing and may by order setting forth its reasons therefor, upon complaint or upon its own motion, upon reasonable notice, enter upon a hearing concerning the lawfulness of such rate, and the commission may, at any time by vote of a majority of the members of the commission serving in accordance with law, permit such tariff to become effective, except that

absent such order such tariff shall be suspended for a period not to exceed seven months from the time such rate would otherwise become effective. Before the expiration of such seven-month period, a majority of the members of the commission serving in accordance with law, acting unanimously, shall make a final decision and order, setting forth its reasons therefor, granting or denying, in whole or in part, the general rate increase requested. If, however, such an order has not been made at the expiration of such seven-month period, the proposed general rate increase shall go into effect at the end of such period, but the commission may by order require the interested public utility to refund, in accordance with section 1312 (relating to refunds), to the persons in whose behalf such amounts were paid, such portion of such increased rates as by its decision shall be found not justified, plus interest, which shall be the average rate of interest specified for residential mortgage lending by the Secretary of Banking in accordance with the act of January 30, 1974 (P.L.13, No.6), referred to as the Loan Interest and Protection Law, during the period or periods for which the commission orders refunds. The rate in force when the tariff stating such new rate was filed shall continue in force during the period of suspension unless the commission shall grant extraordinary rate relief as prescribed in subsection (e). The commission shall consider the effect of such suspension in finally determining and prescribing the rates to be thereafter charged and collected by such public utility, except that the commission shall have no authority to prescribe, determine or fix, at any time during the pendency of a general rate increase proceeding or prior to a final determination of a general rate increase request, temporary rates as provided in section 1310,

which rates may provide retroactive increases through recoupment. As used in this part general rate increase means a tariff filing which affects more than 5% of the customers and amounts to in excess of 3% of the total gross annual intrastate operating revenues of the public utility. If the public utility furnishes two or more types of service, the foregoing percentages shall be determined only on the basis of the customers receiving, and the revenues derived from, the type of service to which the tariff filing pertains.

(d.1) Multiple filings prohibited.—Except as required to implement an order granting extraordinary rate relief, no public utility which has filed a general rate increase request pursuant to this section shall file an additional general rate increase request pursuant to this section for the same type of service until the commission has made a final decision and order on the prior general rate increase request or until the expiration of the maximum period of suspension of the prior general rate increase request pursuant to this section, whichever is earlier.

(e) Extraordinary rate relief.—Upon petition to the commission at the time of filing of a rate request or at any time during the pendency of proceedings on such rate request, any public utility may seek extraordinary rate relief of such portion of the total rate relief requested as can be shown to be immediately necessary for the maintenance of financial stability in order to enable the utility to continue providing normal services to its customers, avoid reductions in its normal maintenance programs, avoid substantially reducing its employment, and which will provide no more than the rate of return on the utility's common equity established by

the commission in consideration of the utility's preceding rate filing, except that no utility shall file, either with a request for a general rate increase or at any time during the pendency of such a request, more than one petition under this subsection pertaining to rates for a particular type of service, nor any supplement or amendment thereto, except when permitted to do so by order of the commission. Any public utility requesting extraordinary rate relief shall file with the petition sufficient additional testimony and exhibits which will permit the commission to make appropriate findings on the petition. The public utility shall give notice of the petition in the same manner as its filing upon which this petition is based. The commission shall within 30 days from the date of the filing of a petition for extraordinary rate relief, and after hearing for the purpose of cross-examination of the testimony and exhibits of the public utility, and the presentation of such other evidentiary testimony as the commission may by rule prescribe, by order setting forth its reasons therefor, grant or deny, in whole or in part, the extraordinary relief requested. Absent such order, the petition shall be deemed to have been denied. Rates established pursuant to extraordinary rate relief shall not be deemed to be temporary rates within the meaning of that term as it is used in section 1310.

(f) Limitation on rate increases by certain public utilities.—Whenever there is filed with the commission any tariff stating a new rate based in whole or in part on the cost of constructing an electric generating unit, the commission shall compare the estimated construction cost filed in accordance with section 515(a) (relating to construction cost of electric generating units)

with the actual construction cost submitted by the utility in support of that tariff. If the actual construction cost exceeds the estimated construction cost, the rate determined by the commission under this section shall not be based on any part of that excess unless the public utility proves that part of the excess to have been necessary and proper. In making its determination under this subsection, the commission shall consider all relevant and material evidence, including evidence obtained pursuant to section 515. For purposes of this subsection "construction" includes any work performed on an electric generating unit which required, or is expected to require, the affected public utility to incur an aggregate of at least $100,000,000 of expenses which, in accordance with generally accepted accounting principles, are capital expenses and not operating or maintenance expenses.

(July 6, 1984, P.L.602, No.123, eff. imd.; Sept. 27, 1984, P.L.721, No.153, eff. imd.; Dec. 21, 1984, P.L.1265, No.240, eff. imd.)

1984 Amendments. Act 123 added subsec. (f), Act 153 added subsec. (d.1) and Act 240 amended subsec. (a) and added subsec. (d.1). The amendments by Acts 153 and 240, adding subsec. (d.1), are substantially the same and both have been given effect in setting forth the text of subsec (d.1). See section 5 of Act 123 in the appendix to this title for special provisions relating to submission of cost estimate for units not completed.

Cross References. Section 1308 is referred to in sections 306, 523, 1316, 1318, 1325 of this title.

§ 1309. Rates fixed on complaint; investigation of costs of production.

Whenever the commission, after reasonable notice and hearing, upon its own motion or upon complaint,

finds that the existing rates of any public utility for any service are unjust, unreasonable, or in anywise in violation of any provision of law, the commission shall determine the just and reasonable rates, including maximum or minimum rates, to be thereafter observed and in force, and shall fix the same by order to be served upon the public utility, and such rates shall constitute the legal rates of the public utility until changed as provided in this part. Whenever a public utility does not itself produce or generate that which it distributes, transmits, or furnishes to the public for compensation, but obtains the same from another source, the commission shall have the power and authority to investigate the cost of such production or generation in any investigation of the reasonableness of the rates of such public utility.

Cross References. Section 1309 is referred to in sections 514, 521 of this title.

§ 1310. Temporary rates.

(a) General rule.—The commission may, in any proceeding involving the rates of a public utility, except a proceeding involving a general rate increase, brought either upon its own motion or upon complaint, after reasonable notice and hearing, if it be of opinion that the public interest so requires, immediately fix, determine, and prescribe temporary rates to be charged by such public utility, pending the final determination of such rate proceeding. Such temporary rates, so fixed, determined, and prescribed, shall be sufficient to provide a return of not less than 5% upon the original cost, less accrued depreciation, of the physical property, when first devoted to public use, of such public utility, used and useful in the public service, and if the duly verified reports of such public utility to the commission do not

show such original cost, less accrued depreciation, of such property, the commission may estimate such cost less depreciation and fix, determine, and prescribe rates as hereinbefore provided.

(b) Exception where records unavailable.—If any public utility does not have continuing property records, kept in the manner prescribed by the commission under the provisions of section 1702 (relating to continuing property records), then the commission, after reasonable notice and hearing, may establish temporary rates which shall be sufficient to provide a return of not less than an amount equal to the operating income for such prior calendar, fiscal or other year as the commission may deem proper, to be determined on the basis of data appearing in the annual report of such public utility to the commission for such prior year as the commission may deem proper, plus or minus such return as the commission may prescribe from time to time upon such net changes of the physical property as are reported to and approved for rate-making purposes by the commission. In determining the net changes of the physical property, the commission may, in its discretion, deduct from gross additions to such physical property the amount charged to operating expenses for depreciation or, in lieu thereof, it may determine such net changes by deducting retirements from the gross additions. The commission, in determining the basis for temporary rates, may make such adjustments in the annual report data as may, in the judgment of the commission, be necessary and proper.

(c) Periodicity of rates.—The commission may fix, determine, and prescribe temporary rates every month, or at any other interval, if it be of opinion that the public interest so requires, and the existence of proceedings begun for the purpose of establishing final rates shall not prevent the commission from changing every month, or at any other interval, such temporary rates as it has previously fixed, determined, and prescribed.

(d) Excessive rates.—Whenever the commission, upon examination of any annual or other report, or of any papers, records, books, or documents, or of the property of any public utility, shall be of opinion that any rates of such public utility are producing a return in excess of a fair return upon the fair value of the property of such public utility, used and useful in its public service, the commission may, by order, prescribe for a trial period of a least six months, which trial period may be extended for one additional period of six months, such temporary rates to be observed by such public utility as, in the opinion of the commission, will produce a fair return upon such fair value, and the rates so prescribed shall become effective upon the date specified in the order of the commission. Such rates, so prescribed, shall become permanent at the end of such trial period, or extension thereof, unless at any time during such trial period, or extension thereof, the public utility involved shall complain to the commission that the rates so prescribed are unjust or unreasonable. Upon such complaint, the commission, after hearing, shall determine the issues involved, and pending final determination the rates so prescribed shall remain in effect.

(e) Effect and adjustment of rates.—Temporary rates so fixed, determined, and prescribed under this section shall be effective until the final determination of the rate proceeding, unless terminated sooner by the commission. In every proceeding in which temporary rates are fixed, determined, and prescribed under this section,

the commission shall consider the effect of such rates in fixing, determining, and prescribing rates to be thereafter demanded or received by such public utility on final determination of the rate proceeding.

Effective Date. Section 3 of Act 116 of 1978 provided that the provisions of section 1310, insofar as they are different from the law repealed by Act 116, shall take effect October 7, 1977.

Cross References. Section 1310 is referred to in sections 306, 1308 of this title.

§ 1311. Valuation of and return on the property of a public utility.

(a) Valuation generally.—The commission may, after reasonable notice and hearing, ascertain and fix the value of the whole or any part of the property of any public utility, insofar as the same is material to the exercise of the jurisdiction of the commission, and may make revaluations from time to time in the value of rate base of a public utility on account of all new construction, extensions, additions and retirements to the property of any public utility.

(b) Method of valuation.—The value of the property of the public utility included in the rate base shall be the original cost of the property when first devoted to the public service less the applicable accrued depreciation as such depreciation is determined by the commission.

(c) Segregation of property.—When any public utility furnishes more than one of the different types of utility service, the commission shall segregate the property used and useful in furnishing each type of such service, and shall not consider the property of such public utility as a unit in determining the value of the rate base of such public utility for the purpose of fixing rates.

(d) Common carriers.—In fixing any rate of a public utility engaged exclusively as a common carrier by motor vehicle, the commission may, in lieu of other standards established by law, fix the fair return by relating the fair and reasonable operating expenses, depreciation, taxes and other costs of furnishing service to operating revenues.

(Sept. 27, 1984, P.L. 721, No. 153, eff. 60 days; Dec. 21, 1984, P.L. 1265, No. 240, eff. imd.)

1984 Amendments. Acts 153 and 240 amended the entire section. Act 240 overlooked the amendment by Act 153 but the amendments do not conflict in substance and have been given effect in setting forth the text of the section.

§ 1312. Refunds.

(a) General rule.—If, in any proceeding involving rates, the commission shall determine that any rate received by a public utility was unjust or unreasonable, or was in violation of any regulation or order of the commission, or was in excess of the applicable rate contained in an existing and effective tariff of such public utility, the commission shall have the power and authority to make an order requiring the public utility to refund the amount of any excess paid by any patron, in consequence of such unlawful collection, within four years prior to the date of the filing of the complaint, together with interest at the legal rate from the date of each such excessive payment. In making a determination under this section, the commission need not find that the rate complained of was extortionate or oppressive. Any order of the commission awarding a refund shall be made for and on behalf of all patrons subject to the same rate of the public utility. The commission shall state in any refund order the exact amount to be

paid, the reasonable time within which payment shall be made, and shall make findings upon pertinent questions of fact.

(b) Suit for refund.—If the public utility fails to make refunds within the time for payment fixed by any final order of the commission or court, any patron entitled to any refund may sue therefor and the findings and order made by the commission shall be prima facie evidence of the facts therein stated, and that the amount awarded is justly due the plaintiff in such suit, and the defendant public utility shall not be permitted to avail itself of the defense that the service was, in fact, rendered to the plaintiff at the rate contained in its tariffs in force at the time payment was made and received, nor shall the defendant public utility be permitted to avail itself of the defense that the rate was reasonable. Any patron entitled to any refund shall be entitled to recover, in addition to the amount of refund, a penalty of 50% of the amount of such refund, together with all court costs and reasonable attorney fees. No suit may be maintained for a refund unless instituted within one year from the date of the order of the commission or court. Any number of patrons entitled to such refund may join as plaintiffs and recover their several claims in a single action, in which action the court shall render a judgment severally for each plaintiff as his interest may appear.

(c) Conditions for suit.—No action shall be brought in any court for a refund, unless and until the commission shall have determined that the rate in question was unjust or unreasonable, or in violation of any regulation or order of the commission, or in excess of the applicable rate contained in an existing and effective tariff, and

then only to recover such refunds as may have been awarded and directed to be paid by the commission in such order.

Cross References. Section 1312 is referred to in section 1308 of this title.

§ 1313. Price upon resale of public utility services.

Whenever any person, corporation or other entity, not a public utility, electric cooperative corporation, municipality authority or municipal corporation, purchases service from a public utility and resells it to consumers, the bill rendered by the reseller to any residential consumer shall not exceed the amount which the public utility would bill its own residential consumers for the same quantity of service under the residential rate of its tariff then cuurently in effect.

Cross References. Section 1313 is referred to in section 3313 of this title.

§ 1314. Limitation on prices paid for property and fuel.

The commission shall adopt regulations prohibiting public utilities subject to its jurisdiction from paying for or agreeing to pay for goods, services, equipment or fuels at prices in excess of those contained in contracts existing between the utilities and providers of such goods, services, equipment or fuel services.
(Nov. 26, 1978, No.297, eff. 60 days)

1978 Amendment. Act 297 added section 1314.

§ 1315. Limitation on consideration of certain costs for electric utilities.

Except for such nonrevenue producing, nonexpense reducing investments as may be reasonably shown to be necessary to improve environmental conditions at exist-

ing facilities or improve safety at existing facilities or as may be required to convert facilities to the utilization of coal, the cost of construction or expansion of a facility undertaken by a public utility producing, generating, transmitting, distributing or furnishing electricity shall not be made a part of the rate base nor otherwise included in the rates charged by the electric utility until such time as the facility is used and useful in service to the public. Except as stated in this section, no electric utility property shall be deemed used and useful until it is presently providing actual utility service to the customers.

(Dec. 30, 1982, P.L.1473, No.335, eff. imd.)

1982 Amendment. Act 335 added section 1315. Section 2 of Act 335 provided that the act shall be applicable to all proceedings pending before the Public Utility Commission and the courts at this time and also provided that nothing contained in the act shall be construed to modify or change existing law with regard to rate making treatment of investment in facilities of fixed utilities other than electric utilities.

Cross References. Section 1315 is referred to in sections 514, 521, 1319 of this title.

§ 1316. Recovery of advertising expenses.

(a) General rule.—For purposes of rate determinations, no public utility may charge to its consumers as a permissible operating expense for ratemaking purposes any direct or indirect expenditure by the utility for political advertising. The commission shall also disallow as operating expense for ratemaking purposes expenditures for other advertising, unless and only to the extent that the commission finds that such advertising is reasonable and meets one or more of the following criteria:

(1) Is required by law or regulation.

(2) Is in support of the issuance, marketing or acquisition of securities or other forms of financing.

(3) Encourages energy independence by promoting the wise development and use of domestic sources of coal, oil or natural gas and does not promote one method of generating electricity as preferable to other methods of generating electricity.

(4) Provides important information to the public regarding safety, rate changes, means of reducing usage or bills, load management or energy conservation.

(5) Provides a direct benefit to ratepayers.

(6) Is for the promotion of community service or economic development.

(b) Charging expenses to stockholders.—Any direct or indirect expenditure by a public utility for political advertising, or any other advertising not meeting the criteria set forth in subsection (a), shall be charged to its stockholders and shall not be included as an operating expense for ratemaking purposes.

(c) Filing of information and materials.—Whenever a public utility proposes a change in rates under section 1308 (relating to voluntary changes in rates), the public utility shall file with the commission a listing of each type of advertising prepared, distributed or presented by the public utility or to be prepared, distributed or presented by the public utility during the test year utilized by the public utility in discharging its burden of proof, and a listing of each type of advertising prepared, distributed or presented by the public utility during the year immediately preceding the test year, as well as an accounting of the expenditures by the public utility for such advertising, to the extent such advertis-

ing is proposed to be included as operating expense for ratemaking purposes. The filing requirements imposed by this subsection shall not be construed to limit the right of any party to discovery under this or any other provision of law.

(d) Definition.—As used in this section the term "political advertising" means any advertising for the purpose of influencing public opinion with respect to any legislative, administrative action or candidate election or with respect to any controversial issue to be decided by public voting. The term includes money spent for lobbying but not money spent for appearances before regulatory or other governmental bodies in connection with a public utility's existing or proposed operations.
(Mar. 7, 1984, P.L.104, No.22, eff. 60 days; July 10, 1986, P.L.1238, No.114, eff.imd.)

§ 1316.1. Recovery of club dues.

No public utility may charge to its customers as a permissible operating expense for ratemaking purposes membership fees, dues or charges to fraternal, social or sports clubs or organizations.
(July 10, 1986, P.L.1238, No.114, eff.imd.)

1986 Amendment. Act 114 added section 1316.1.

§ 1317. Regulation of natural gas costs.

(a) General rule.—In every rate proceeding instituted by a natural gas distribution utility, pursuant to section 1307(f) (relating to sliding scale of rates; adjustments), each such utility shall be required to provide to the commission such information, to be established by commission regulation within 120 days of the passage of this section, that will permit the commission to make specific findings as to whether the utility is pursuing a least cost fuel procurement policy, consistent with the utility's obligation to provide safe, adequate and reliable service to its customers. Such information shall include, but need not be limited to, information, data and statements regarding:

(1) The utility's participation in rate proceedings before the Federal Energy Regulatory Commission which affect the utility's gas costs.

(2) The utility's efforts to negotiate favorable contracts with gas suppliers and to renegotiate existing contracts with gas suppliers or take legal actions necessary to relieve the utility from existing contract terms which are or may be adverse to the interests of the utility's ratepayers.

(3) The utility's efforts to secure lower cost gas supplies both within and outside of the Commonwealth, including the use of transportation arrangements with pipelines and other gas distribution companies.

(4) The sources and amounts of all gas supplies which have been withheld or have been caused to be withheld from the market by the utility and the reasons why such gas is not to be utilized.

(b) Integrated gas companies.—In the case of a natural gas distribution utility which purchases all or part of its gas supplies from an affiliated interest, as that term is defined in section 2101 (relating to definition of affiliated interest), such utility shall, in addition to the materials required in subsection (a), be required to provide to the commission such information, to be established by commission regulation within 120 days of the passage of this section, that will permit the commission to make specific findings as to whether any purchases of gas from an affiliated interest are consistent with a least cost fuel procurement policy, consistent

with the utility's obligation to provide safe, adequate and reliable service to its customers. Such information shall include, but need not be limited to, statements regarding:

(1) Efforts made by the utility to obtain gas supplies from nonaffiliated interests.

(2) The specific reasons why the utility has purchased gas supplies from an affiliated interest and demonstration that such purchases are consistent with a least cost fuel procurement policy.

(3) The sources and amounts of all gas supplies which have been withheld from the market by the utility or any affiliated interest and the reasons why such gas is not being utilized.

(c) Definition.—As used in this section the term "natural gas" includes natural gas, liquified natural gas, synthetic natural gas and any natural gas substitutes.
(May 31, 1984, P.L.370, No.74, eff. 60 days)

1984 Amendment. Act 74 added section 1317. See section 5 of Act 74 in the appendix to this title for special provisions relating to applicability.

Cross References. Section 1317 is referred to in sections 1318, 2107 of this title.

§ 1318. Determination of just and reasonable natural gas rates.

(a) General rule.—In establishing just and reasonable rates for those gas distribution utilities with gross intrastate operating revenues in excess of $40,000,000 under section 1307(f) (relating to sliding scale of rates; adjustments) or 1308(d) (relating to voluntary changes in rates) or any other rate proceeding, the commission shall consider the materials provided by the utilities pursuant to section 1317 (relating to regulation of natural gas costs). No rates for a natural gas distribution utility shall be deemed just and reasonable unless the commission finds that the utility is pursuing a least cost fuel procurement policy, consistent with the utility's obligation to provide safe, adequate and reliable service to its customers. In making such a determination, the commission shall be required to make specific findings which shall include, but need not be limited to, findings that:

(1) The utility has fully and vigorously represented the interests of its ratepayers in proceedings before the Federal Energy Regulatory Commission.

(2) The utility has taken all prudent steps necessary to negotiate favorable gas supply contracts and to relieve the utility from terms in existing contracts with its gas suppliers which are or may be adverse to the interests of the utility's ratepayers.

(3) The utility has taken all prudent steps necessary to obtain lower cost gas supplies on both short-term and long-term bases both within and outside the Commonwealth, including the use of gas transportation arrangements with pipelines and other distribution companies.

(4) The utility has not withheld from the market or caused to be withheld from the market any gas supplies which should have been utilized as part of a least cost fuel procurement policy.

(b) Limitation on gas purchased from affiliates.—In any instance in which a gas distribution utility purchases all or part of its gas supplies from an affiliated interest, as that term is defined in section 2101 (relating to definition of affiliated interest), the commission, in addition to the determinations and findings set forth in subsection (a), shall be required to make specific

findings with regard to the justness and reasonableness of all such purchases. Such findings shall include, but not be limited to findings:

(1) That the utility has fully and vigorously attempted to obtain less costly gas supplies on both short-term and long-term bases from nonaffiliated interests.

(2) That each contract for the purchase of gas from its affiliated interest is consistent with a least cost fuel procurement policy.

(3) That neither the utility nor its affiliated interest has withheld from the market any gas supplies which should have been utilized as part of a least cost fuel procurement policy.

(c) Shut-in gas; special rule.—In determining whether a gas utility has purchased the least costly natural gas available, the commission shall consider as available to the utility any gas supplies that reasonably could have been brought to market during the relevant period but which were voluntarily withheld from the market by the utility or an affiliated interest of the utility.

(d) Other regulatory approvals.—The fact that a contract or rate has been approved by a Federal regulatory agency for interstate ratemaking purposes shall not, in and of itself, be adequate to satisfy the utility's burden of proof that gas prices and volumes associated with such contract or rate are just and reasonable for purposes of this section.

(e) Reports.—Each natural gas distribution utility with gross intrastate annual operating revenues in excess of $40,000,000 shall file with the commission and the Office of Consumer Advocate, in accordance with regulations to be prescribed by the commission, quarterly reports setting forth the actual gas costs incurred by the utility on a monthly basis. Actual gas costs shall be reviewed for their accuracy by the Bureau of Audits at least annually and the results of that review shall be submitted to the commission.

(f) Definition.—As used in this section the term "natural gas" includes natural gas, liquified natural gas, synthetic natural gas and any natural gas substitutes. (May 31, 1984, P.L.370, No.74, eff. 60 days)

1984 Amendment. Act 74 added section 1318. See section 5 of Act 74 in the appendix to this title for special provisions relating to applicability.

Cross References. Section 1318 is referred to in sections 1307, 2107 of this title.

§ 1319. Financing of energy supply alternatives.

(a) Recovery of certain additional expenses.—If:

(1) a natural gas or electric public utility elects to establish a conservation or load management program and that program is approved by the commission after a determination by the commission that the program is prudent and cost-effective; or

(2) the commission orders a natural gas or electric public utility to establish a conservation or load management program that the commission determines to be prudent and cost-effective;

the commission shall allow the public utility to recover all prudent and reasonable costs associated with the development, management, financing and operation of the program, provided that such prudent and reasonable costs shall be recovered only in accordance with appropriate accounting principles. Nothing in this section shall permit the recovery of costs in a manner prohibited by section 1315 (relating to limitation on consideration of certain costs for electric utilities). Nothing in

this section shall permit the recovery of the cost of producing, generating, transmitting, distributing or furnishing electricity or natural gas.

(b) Option for recovery.—The commission may consider allowing the recovery of those costs permitted to be recovered by subsection (a) through charges to those persons who are participants in the financing program.
(Dec. 21, 1984, P.L.1270, No.241 eff. imd.; July 10, 1986, P.L.1238, No.114, eff. imd.)

§ 1320. Fuel purchase audits by complaint.

(1) Upon complaint, the commission shall conduct an audit of an electric public utility's purchases of fuel for generating purposes. Such an audit shall examine the utility's fuel purchasing activities for the two years prior to the date of such complaint, provided that:

(i) The utility does its own testing or procures its own analysis of its fuel.

(ii) The fuel cost of the utility for the most recently completed fiscal year exceeds that of the prior fiscal year by more than 5%.

(iii) The commission has not completed and made available to the public a fuel purchase audit of the utility in the past two years.

(2) This audit, which shall be completed within one year of the date of initiation of the complaint, shall include, but not be limited to, a comparison of unit price paid for fuel for generating purposes, considering such factors as ash, sulfur content, British thermal units, transportation costs and reliability of supply.

(3) The audit shall seek to determine whether the public utility's fuel purchasing procedures are conducted in such a manner as to result in the greatest benefit to the ratepayers.

(4) The commission's audit report shall contain recommendations as to methods by which the utility's fuel purchasing procedures can be adjusted so as to result in the greatest benefit to the ratepayers.

(5) The commission shall take the audit report into consideration at the utility's next request for a rate adjustment.

(6) Upon completion and release by the commission, copies of the audit report summary shall be mailed to every person who requests a copy.
(July 10, 1986, P.L. 1238, No. 114, eff. imd.)

1986 Amendment. Act 134 added section 1320.

§ 1321. Recovery of certain employee meeting expenses.

No public utility may charge to its customers as a permissible operating expense for ratemaking purposes any portion or portions of the direct or indirect costs of meetings, conferences, seminars or other events conducted by the utility for its employees, managers or directors which portion or portions of such costs represent expenditures for activities or items unrelated to the business or civic purpose of the event, such as costs for entertainment, recreation, athletic activities, personal clothing or other personal effects.
(July 10, 1986, P.L. 1238, No. 114, eff. imd.)

1986 Amendment. Act 114 added section 1321.

§ 1322. Outages of electric generating units.

(a) General rule.—Whenever an electric generating unit, determined by the commission to be a base load unit, is out of service for more than 120 consecutive days, a utility owning a share of that unit shall not be permitted to recover, through base rates, a sliding scale of rates, or by any other means, the excess energy costs incurred to generate or purchase replacement power

occasioned by any portion of the outage which the commission determines to be unreasonable or imprudent. In making its determination under this subsection, the commission shall consider, in addition to any other relevant evidence, whether the outage could have been shortened or avoided if the unit had been properly constructed, operated or maintained.

(b) Notice of outage.—Whenever an electric generating unit, determined by the commission to be a base load unit, is out of service for 45 consecutive days, any utility owning a share of that unit shall submit to the commission and the Office of Consumer Advocate a status report on that outage. The utility shall submit subsequent status reports on the outage to the commission and the Office of Consumer Advocate at least by the 20th day of each subsequent month until the unit returns to service. If more than one utility owns a share in the electric generating unit, the commission may designate one utility to make the reports required by this subsection.

(c) Operation at less than reasonable level of generation.—Whenever the actual generation of an electric generating unit, determined by the commission to be a base load unit, is less than 50% of the unit's potential generation during any calendar year or other 12-month period specified by the commission, the commission, on its own motion or upon complaint, may initiate an investigation to determine a reasonable level of generation for that unit. In establishing rates as part of that investigation or in any subsequent proceeding, the commission shall not permit recovery of the excess energy costs incurred to generate or purchase replacement power occasioned by the failure of the unit to operate at

or above such reasonable level of generation, if such failure is determined to be unreasonable or imprudent.

(d) Procedure.—In carrying out its powers and duties under this section, the commission may hold such hearings as it deems necessary. The utility shall have the burden of proof in any proceeding under this section.

(e) Other powers and duties preserved.—This section shall not be construed to diminish the powers and duties of the commission under any other provision of law to reduce rates in the event of an outage of an electric generating unit, regardless of the duration of that outage.

(f) Definition.—As used in this section the term "excess energy costs" means the additional costs incurred to purchase or generate replacement power minus the fuel costs which would have been incurred to generate an equivalent amount of power from the affected base load unit.

(July 10, 1986, P.L. 1238, No. 114, eff. imd.)

1986 Amendment. Act 114 added section 1322.

§ 1323. Procedures for new electric generating capacity.

(a) Excess capacity costs.—Whenever a public utility claims the costs of an electric generating unit in its rates for the first time and the commission finds that the unit results in the utility having excess capacity, the commission shall disallow from the utility's rates, in the same proportion as found to be excess capacity:

(1) the return on specific unit or units of any excess generating reserve;

(2) the return on the average net original cost per megawatt of the utility's generating capacity; or

(3) the equity investment in the new unit.

In addition to the dissallowances set forth in this subsection, the commission may dissallow any other costs of the unit or units which the commission deems appropriate. For the purposes of this section, a rebuttable presumption is created that a unit or units or portion thereof shall be determined to be excess unless found to be needed to meet the utility's customer demand plus a reasonable reserve margin in the test year or the year following the test year, or, if it is a base load unit, it is also found to produce annual economic benefits which will exceed the total annual cost of the plant during the test year or within a reasonable period following the test year.

(b) Units which are out of service.—Whenever an electric generating unit, determined by the commission to be a base load unit, is first claimed in the rates of a public utility and the unit is out of service at the time that the commission makes its final decision in the case in which the unit's costs are claimed, the commission shall make either of the following adjustments:

(1) exclude from the utility's rates all costs associated with the unit; or

(2) for a period of one year from the date of the final decision, require that the utility shall guarantee at least the level of either generation or energy savings, whichever produces the rate or rates most advantageous to the ratepayer, that the utility had estimated would be produced by the unit in the first year of its operation.

An adjustment shall be made under this subsection regardless of whether or not the new base load unit had been in service during or at the end of the test year used in the proceeding.

(c) Other powers and duties preserved.—This section shall not be construed to diminish the powers and duties of the commission under any other provision of law to reduce rates because of excess capacity or any other reason, provided that, in determining whether a base load unit, which was in commercial operation for at least one year prior to the effective date of this section, results in a public utility having excess capacity, cogeneration, for which an agreement has been entered into by the public utility within three years after the in-service date of the base load unit, shall not be considered by the commission in determining the reserve margins or economic benefits resulting from the base load unit for the first five years after the date of the cogeneration agreement.

(d) Record evidence.—Any adjustments to rates made under this section shall be made on the basis of specific findings upon evidence of record, which findings shall be set forth explicitly, together with their underlying rationale, in the final order of the commission.
(July 10, 1986, P.L. 1238, No. 114, eff. imd.)

1986 Amendment. Act 114 added section 1323 and provided in section 19 of the act that section 1323 shall be applicable to all cases pending before the commission.

§ 1324. Residential telephone service rates based on duration or distance of call.

(a) Required charging method.—In addition to any other method of charging offered on an optional basis, a telecommunications utility providing local exchange telephone service to residential customers within a certified exchange area must provide service which charges, for calls originating and terminating within the same local calling area, on the basis of a flat monthiy fee for all such calls made.

(b) Options.—If the commission determines that a telecommunications utility may offer to residential customers an optional method of charging for calls originating and terminating within the same local calling area based, in whole or in part, on the duration or distance of the call, it shall also offer a rate which charges for such calls only on the basis of the number of calls made.

(c) Rate relationship.—In addition to any other requirements imposed by this title, the rates for services required or permitted pursuant to subsections (a) and (b) shall be maintained at just and reasonable levels in comparison to one another.

(d) Nonresidential rates pursuant to another section.—Nothing in this section shall preclude the commission from establishing rates for other classes of telephone service based upon another section of this title.
(July 10, 1986, P.L. 1238, No. 114, eff. imd.)

1986 Amendment. Act 114 added section 1324.

§ 1325. Local exchange service increases; limitation.

(a) General rule.—In any rate proceeding pursuant to section 1308 (relating to voluntary changes in rates), no public utility shall be granted a percentage increase in local exchange service unless that percentage increase is just and reasonable. In no event shall the public utility be granted an increase in local exchange rates which is greater than the overall average percentage increase in total intrastate revenues authorized by the commission unless the utility proves by record evidence that a greater percentage increase for local exchange service is justified based upon the cost of providing that service.

(b) Generic studies permitted.—The commission, after notice and hearing, may promulgate regulations

setting forth appropriate methods of calculating the stand-alone costs of telecommunication services.

(c) Definitions.—As used in this section the following words and phrases shall have the meanings given to them in this subsection:

"Cost of providing local exchange service." The direct cost of providing the service plus a share of the costs of the dial tone line, allocated in proportion to the stand-alone cost of each class of service which utilizes the dial tone line.

"Local exchange service." The intrastate charge for access to the telephone network plus the charge for making calls which originate and terminate within the same calling area.
(July 10, 1986, P.L. 1238, No. 114, eff. imd.)

986 Amendment. Act 114 added section 1325.

APPENDIX M

Post-Embargo Pennsylvania Ratemaking Legislation

TABLE A

SUMMARY OF POST-EMBARGO[1] PENNSYLVANIA RATE MAKING LEGISLATION

Act No.	Subject
1976-226	PUC required to order any public utility which is found to have improperly paid a sum in excess of its contract price for coal during the calendar year 1974 to refund improper excess amounts to consumers.
1982-335	(The act involved in this case.)
1984-22	Excluding from operating expenses for ratemaking any direct or indirect expense for advertising for the purpose of influencing public opinion with respect to any legislation, administrative action or candidate election or with respect to any controversial issue to be decided by public voting (§ 1316).
1984-74	Shared benefits procedure required for electric utilities and the ratepayers as an incentive to implement mandated use of coal as fuel (§ 514).
1984-123	Electric utility may include excess of actual cost over estimated cost of electric generating units costing more than $100 million only upon finding that the excess was "necessary and proper." (§ 1308(f)) (retroactive to start of construction of pending units).

[1]Pennsylvania enacted a comprehensive Public Utility Law in 1937, Act No. 1937-286. This statutory structure was sufficiently flexible that *no* subsequent amendments to Pennsylvania's fixed-service ratemaking methodology were enacted during the pre- and post-*Hope* era prior to the Arab oil embargo.

Act No.	Subject
1984-153 1984-240	Substituting prudent investment (original cost) for fair value rate base (§ 1311).
1984-241	Electric and gas public utilities may recover prudent and reasonable costs associated with conservation or load management programs (§ 1319).
1985-62	Commission may order cancellation or modification of construction of any electric generation unit; for any electric generating unit cancelled after October 10, 1985, either voluntarily or by Commission order Commission to permit return of, but not return on, prudently incurred costs of any partially completed facility when cancellation is found by the Commission to be in the public interest (§ 520).
1986-80	Commission may allow up to 50% of capital cost of uprating existing coal-fired electric generating facility as CWIP notwithstanding § 1315 (§ 514(c)). Commission may allow up to 50% of capital cost of capital additions of existing coal-fired electric generating facility as CWIP notwithstanding § 1315 if Commission has prohibited the utility from retiring the unit or has ordered it returned to normal operation (§ 521(f)).
1986-114	Governor to report annually to the General Assembly on performance of Commission, including but not limited to, a summary of all rate proceedings completed within the

Act No.	Subject
	reporting period, the amount of the rate increase requested in each such proceeding, the amount of the request granted by the commission in each such proceeding, the percentage increase in rates requested and granted in each such proceeding as compared to the percentage increase requested and granted in the most recent similar proceeding for the affected utility prior to the reporting period and other matters (§ 321). Major gas, electric and telephone utilities to use all reasonable efforts to reduce expenses (with certain exceptions) for the calendar year 1986 as compared with 1985 (§ 522). Commission shall consider, in addition to all other relevant evidence of record, the efficiency, effectiveness and adequacy of service of each utility and specified detailed considerations when determining "just and reasonable" rates (§ 523). Commission may reject, in whole or in part, a request for increased rates where Commission finds that quantity or quality of service is inadequate (§ 526). (applicable to all cases pending before the commission or the courts). Rates to the public shall reflect savings to utility from cogeneration (§ 527). All advertising expense shall be disallowed unless expense meets specified statutory criteria (§ 1316).

Act No.	Subject
	All membership fees to fraternal, social or sports clubs shall be disallowed (§ 1316.1).
	All direct or indirect costs of meetings, conferences, seminars or other events conducted by a utility for its employees, managers or directors unrelated to the business or civic purposes of the event, such as costs for entertainment, recreation, athletic activities, personal clothing or other personal effects shall be disallowed (§ 1321).
	Certain costs related to electric generating stations suffering outages shall be disallowed (§ 1322).
	Certain amounts to be disallowed from electric utility's rates upon a finding of excess capacity; if a new generating unit is out of service at time Commission decides rate case (regardless of fact that unit was operating at the end of test year) Commission must either exclude all costs of unit or require one year guarantee at estimated levels of "either generation or energy savings, whichever produces the rate or rates most advantageous to the ratepayer" (§ 1323) (applicable to all cases pending before the commission).

No. 1976-226

AN ACT

HB 2223

Mandating the Public Utility Commisson to require certain utilities to refund to consumers certain sums of moneys.

The General Assembly of the Commonwealth of Pennsylvania hereby enacts as follows:

Section 1. The Public Utility Commission is hereby required to order any public utility which is found by the commission after a hearing to have improperly paid a sum in excess of its contract price for coal during the calendar year 1974 to refund said improper excess amount to its consumers. The Public Utility Commisson shall oversee and direct the process of such refunding of the money to the consumers. The money refunded to the consumers pursuant to this act shall be paid from the equity of the stockholders of said companies.

Section 2. The commission shall adopt regulations which shall prohibit utilities subject to its jurisdiction from paying for or agreeing to pay for goods, services, equipment, or fuels at prices in excess of those contained in contracts existing between such utilities and providers of such goods, services, equipment, or fuel services.

Section 3. This act shall take effect immediately.

APPROVED—The 7th day of October, A.D. 1976.

MILTON J. SHAPP

No. 1982-335

AN ACT

SB 1366

Amending Title 66 (Public Utilities) of the Pennsylvania Consolidated Statutes, providing a limitation on the consideration of certain costs in the rate base for electric public utilities.

The General Assembly of the Commonwealth of Pennsylvania hereby enacts as follows:

Section 1. Title 66, act of November 25, 1970 (P.L.707, No.230), known as the Pennsylvania Consolidated Statutes, is amended by adding a section to read:

§ 1315. Limitation on consideration of certain costs for electric utilities.

Except for such nonrevenue producing, nonexpense reducing investments as may be reasonably shown to be necessary to improve environmental conditions at existing facilities or improve safety at existing facilities or as may be required to convert facilities to the utilization of coal, the cost of construction or expansion of a facility undertaken by a public utility producing, generating, transmitting, distributing or furnishing electricity shall not be made a part of the rate base nor otherwise included in the rates charged by the electric utility until such time as the facility is used and useful in service to the public. Except as stated in this section, no electric utility property shall be deemed used and useful until it is presently providing actual utility service to the customers.

Section 2. This act shall be applicable to all proceedings pending before the Public Utility Commission and

the courts at this time. Nothing contained in this act shall be construed to modify or change existing law with regard to rate making treatment of investment in facilities of fixed utilities other than electric utilities.

Section 3. This act shall take effect immediately.

APPROVED—The 30th day of December, A.D. 1982.

DICK THORNBURGH

No. 1984-22

AN ACT

HB 1241

Amending Title 66 (Public Utilities) of the Pennsylvania Consolidated Statutes, providing for the ownership and maintenance of gas service lines and for gas or electric utility advertising expenses and regulation.

The General Assembly of the Commonwealth of Pennsylvania hereby enacts as follows:

* * *

Section 2. Title 66 is amended by adding sections to read:

§ 1316. Recovery of advertising expenses.

(a) General rule.—For purposes of rate determinations, no gas or electric public utility may charge to its consumers as a permissible operating expense for rate-making purposes any direct or indirect expenditure by the utility for political advertising.

(b) Charging expenses to stockholders.—Any direct or indirect expenditure by a gas or electric utility for political advertising shall be charged to its stockholders and shall not be included as an operating expense for rate-making purposes.

(c) Definition.—As used in this section the term "political advertising" means any advertising for the purpose of influencing public opinion with respect to any legislative, administrative action or candidate election or with respect to any controversial issue to be decided by public voting. The term includes money spent for lobbying but not money spent for appearances before

regulatory or other governmental bodies in connection with a gas or electric public utility's existing or proposed operations.

* * *

APPROVED—The 7th day of March, A.D. 1984.

DICK THORNBURGH

No. 1984-74

AN ACT

HB 132

Amending Title 66 (Public Utilities) of the Pennsylvania consolidated Statutes, providing for commission powers and duties relating to the use of coal; prohibiting certain natural gas utilities from utilizing a sliding scale of rates to recover natural gas costs; and further providing for procedures and standards for regulating the rates of natural gas utilities.

The General Assembly of the Commonwealth of Pennsylvania hereby enacts as follows:

Section 1. Title 66 of the Pennsylvania Consolidated Statutes is amended by adding a section to read:

§ 514. Use of coal.

(a) Upgrading capability to use coal.—The commission shall require utilities to uprate their electric power production by upgrading the capability to use coal in existing coal-fueled plants where economically feasible.

(b) Incentive for uprating.—The commission shall develop a special cost recovery and shared benefits procedure for electric utilities and their ratepayers as an incentive to implement upratings as provided in subsection (a).

* * *

APPROVED—The 31st day of May, A.D. 1984.

DICK THORNBURGH

No. 1984-123

AN ACT

SB 58

Amending Title 66 (Public Utilities) of the Pennsylvania Consolidated Statutes, providing for the transportation of property of unusual value, including money and securities, in armored motor vehicles; regulating construction costs of public utilities; and limiting rate increases.

The General Assembly of the Commonwealth of Pennsylvania hereby enacts as follows:

* * *

Section 3. Section 1308 of Title 66 is amended by adding a subsection to read:

§ 1308. Voluntary changes in rates.

* * *

(f) Limitation on rate increases by certain public utilities.—Whenever there is filed with the commission any tariff stating a new rate based in whole or in part on the cost of constructing an electric generating unit, the commission shall compare the estimated construction cost filed in accordance with section 515(a) (relating to construction cost of electric generating units) with the actual construction cost submitted by the utility in support of that tariff. If the actual construction cost exceeds the estimated construction cost, the rate determined by the commission under this section shall not be based on any part of that excess unless the public utility proves that part of the excess to have been necessary and proper. In making its determination under this subsection, the commission shall consider all relevant and material evidence, including evidence obtained pursuant to sec-

tion 515. For purposes of this subsection "construction" includes any work performed on an electric generating unit which required, or is expected to require, the affected public utility to incur an aggregate of at least $100,000,000 of expenses which, in accordance with generally accepted accounting principles, are capital expenses and not operating or maintenance expenses.

* * *

Section 5. In the case of construction of an electric generating unit begun, but not completed, prior to the effective date, the affected public utility shall, within 30 days after the effective date, submit an estimate of the cost of constructing that unit which was formulated no later than 30 days from the beginning of construction. For the purposes of 66 Pa.C.S. §§ 515 and 1308(f), such estimates shall be deemed to have been filed in accordance with section 515(a). The commission shall promulgate rules and regulations to implement sections 515 and 1308(f) as added by this act.

Section 6. This act shall take effect immediately.

APPROVED—The 6th day of July, A.D. 1984.

DICK THORNBURGH

No. 1984-153

AN ACT

SB 1329

Amending Title 66 (Public Utilities) of the Pennsylvania Consolidated Statutes, prohibiting multiple filings; defining rate base; and regulating valuation.

The General Assembly of the Commonwealth of Pennsylvania hereby enacts as follows:

* * *

Section 4. Section 1311 of Title 66 is amended to read:

§ 1311. Valuation of ***and return on the*** property of a public utility.

(a) Valuation generally.—The commission may, after reasonable notice and hearing, ascertain and fix the **[fair]** value of the whole or any part of the property of any public utility, insofar as the same is material to the exercise of the jurisdiction of the commission, and may make revaluations from time to time **[and ascertain the fair value]** ***in the value of rate base of a public utility on account*** of all new construction, extensions, **[and]** additions ***and retirements*** to the property of any public utility.

(b) Method of valuation.—The value of the property of the public utility included in the rate base shall be the original cost of the property when first devoted to the public service less the applicable accrued depreciation.

(c) Segregation of property.—When any public utility furnishes more than one of the different types of utility service, the commission shall segregate the property used and useful in furnishing each type of such service, and shall not consider the property of such public utili-

ty as a unit in determining the value of the **[property]** ***rate base*** of such public utility for the purpose of fixing rates.

(d) Common carriers.—In fixing any rate of a public utility engaged exclusively as a common carrier by motor vehicle, the commission may, in lieu of other standards established by law, fix the fair return by relating the fair and reasonable operating expenses, depreciation, taxes and other costs of furnishing service to operating revenues.

Section 5. (a) The amendments to 66 Pa.C.S. §§ 102 (relating to definitions), 1307(a) (relating to sliding scale of rates; adjustments) and 1311 (relating to valuation of and return on the property of a public utility) made by this act shall take effect in 60 days.

(b) The amendment to Pa.C.S. § 1308(d.1) (relating to voluntary changes in rates) made by this act shall take effect immediately.

APPROVED—The 27th day of September, A.D. 1984.

DICK THORNBURGH

NO. 1984-240

AN ACT

SB 1196

Amending Title 66 (Public Utilities) of the Pennsylvania Consolidated Statutes, providing for rate communications to utility customers; defining "rate base"; regulating valuation; prohibiting certain natural gas utilities from utilizing a sliding scale of rates to recover natural gas costs; further providing for commission powers and duties relating to the use of coal, and for procedures and standards for regulating the rates of natural gas utilities; and making a repeal.

The General Assembly of the Commmonwealth of Pennsylvania hereby enacts as follows:

* * *

Section 6. Section 1311 of Title 66 is amended to read:

§ 1311. Valuation of ***and return on the*** property of a public utility.

(a) Valuation generally.—The commission may, after reasonable notice and hearing, ascertain and fix the **[fair]** value of the whole or any part of the property of any public utility, insofar as the same is material to the exercise of the jurisdiction of the commission, and may make revaluations from time to time **[and ascertain the fair value]** ***in the value of rate base of a public utility on account*** of all new construction, extensions, **[and]** additions ***and retirements*** to the property of any public utility.

(b) Method of valuation.—The value of the property of the public utility included in the rate base shall be the original cost of the property when first devoted to the public service less the applicable accrued depreciation as such depreciation is determined by the commission.

*(c) **Segregation of property.***—When any public utility furnishes more than one of the different types of utility service, the commission shall segregate the property used and useful in furnishing each type of such service, and shall not consider the property of such public utility as a unit in determining the value of the [**property**] ***rate base*** of such public utility for the purpose of fixing rates.

*(d) **Common carriers.***—In fixing any rate of a public utility engaged exclusively as a common carrier by motor vehicle, the commission may, in lieu of other standards established by law, fix the fair return by relating the fair and reasonable operating expenses, depreciation, taxes and other costs of furnishing service to operating revenues.

* * *

Section 9. This act shall take effect immediately.

APPROVED—The 21st day of December, A.D. 1984.

DICK THORNBURGH

No. 1984-241

AN ACT

SB 1330

Amending Title 66 (Public Utilities) of the Pennsylvania Consolidated Statutes, further defining the term "public utility"; and providing for the conversion of generating units from oil or gas to coal and for the recovery of conversion costs, for the approval of the construction of generating units fueled by nuclear energy, oil or natural gas and for the financing of energy supply alternatives.

The General Assembly of the Commonwealth of Pennsylvania hereby enacts as follows:

* * *

§ 1319. Financing of energy supply alternatives.

(a) Recovery of certain additional expenses.—If a natural gas or electric public utility elects to establish a conservation or load management program and that program is approved by the commission after a determination by the commission that the program is prudent and cost-effective, the commission shall allow the public utility to recover all prudent and reasonable costs associated with the development, management, financing and operation of the program, provided that such prudent and reasonable costs shall be recovered only in accordance with appropriate accounting principles. Nothing in this section shall permit the recovery of costs in a manner prohibited by section 1315 (relating to limitation on consideration of certain costs for electric utilities). Nothing in this section shall permit the recovery of the cost of producing, generating, transmitting, distributing or furnishing electricity or natural gas.

(b) Option for recovery.—The commission may consider allowing the recovery of those costs permitted to be recovered by subsection (a) through charges to those persons who are participants in the financing program.

* * *

Section 4. (a) The amendments adding sections 518 and 519 shall take effect in 60 days.

(b) The remainder of this act shall take effect immediately.

APPROVED—The 21st day of December, A.D. 1984.

DICK THORNBURGH

No. 1985-62

AN ACT

SB 543

Amending Title 66 (Public Utilities) of the Pennsylvania Consolidated Statutes, further defining "public utility"; further providing that the transcript of public hearings be considered part of the record in proceedings before the commission; and providing the Public Utility Commission with authority to order electric utilities to cancel or modify construction of generating units.

The General Assembly of the Commonwealth of Pennsylvania hereby enacts as follows:

* * *

Section 3. Title 66 is amended by adding a section to read:

§ 520. Power of commission to order cancellation or modification of construction of electric generating units.

(a) General rule.—The commission shall order any public utility engaged in producing, generating, transmitting, distributing or furnishing electricity to cancel or modify the construction of, or its participation in the construction of, any generating unit where the commission, after notice and an opportunity for hearing, determines that the construction is not in the public interest. In addition to any other relevant matters, the commission shall consider in its determination whether:

(1) The generating unit is necessary for the utility to provide adequate and reliable service to the public.

(2) There are less costly alternatives by which the utility could maintain its ability to provide adequate and reliable service.

(b) Investigations and hearings.—For the purpose of enabling the commission to make its determination, it may hold hearings, make inquiries and require the submission of information which it deems necessary or proper in enabling it to reach a determination. The burden of proof at these hearings to show that construction of the generating unit is in the public interest shall be on the public utility.

(c) Regulatory treatment of costs.—Notwithstanding any other provisions of this title, for a generating unit canceled after the effective date of this section, either voluntarily or by commission order, an electric utility may be permitted to recover a return of, but not a return on, prudently incurred costs on any partially completed facility when cancellation is found by the commission to be in the public interest. The burden of proof to show that any costs claimed were prudently incurred shall be on the public utility.

* * *

Section 5. (a) Sections 1, 2 and 4 of this act shall take effect in 60 days.

(b) The remainder of this act shall take effect immediately.

APPROVED—The 10th day of October, A.D. 1985.

DICK THORNBURGH

NO. 1986-80

AN ACT

HB 258

Amending Title 66 (Public Utilities) of the Pennsylvania Consolidated Statutes, adding provisions to allow limited construction work in progress for coal plants; and providing for retirement of electric generating units.

The General Assembly of the Commonwealth of Pennsylvania hereby enacts as follows:

Section 1. Section 514 of Title 66 of the Pennsylvania Consolidated Statutes is amended to read:

§ 514. Use of coal.

(a) Upgrading capability to use coal.—The commission shall promulgate regulations which require utilities to uprate their electric power production by **[upgrading]** ***increasing*** the capability to use coal in existing coal-fueled plants where economically feasible and where the uprate is beneficial to ratepayers.

(b) Incentive for uprating.—The commission shall promulgate regulations which establish a special cost recovery and shared benefits procedure for electric utilities and their ratepayers as an incentive to implement upratings as provided in subsection (a). Nothing in this section shall permit or require the commission to establish rates or procedures which are inconsistent with any other section in this title.

(c) Cost of upgrading.—Notwithstanding section 1315 (relating to limitation on consideration of certain costs for electric utilities) and subject to regulations promulgated by the commission, the commission may allow a portion of the prudently incurred costs, determined on a

per megawatt basis and not to exceed 50% of the unit's undepreciated original cost per megawatt, of uprating the capability of an existing coal-fueled plant to use coal mined in Pennsylvania to be made a part of the rate base or otherwise included in the rates charged by the utility before such uprating is completed. This subsection shall not apply unless, upon application of the affected public utility, the commission determines that the uprating would be more cost effective for the utility's ratepayers than other alternatives for meeting the utility's load and capacity requirements. Notwithstanding section 1309 (relating to rates fixed on complaint; investigation of costs of production), the commission, by regulation, shall provide for a utility to remove the costs of an uprating from its rate base and to refund any revenues collected as the result of this subsection, plus interest, which shall be the average rate of interest specified for residential mortgage lending by the Secretary of Banking in accordance with the act of January 30, 1974 (P.L. 13, No. 6), referred to as the Loan Interest and Protection Law, during the period or periods for which the commission orders refunds, if the commission, after notice and hearings, determines that the uprating has not been completed within a reasonable time.

Section 2. Section 517(e) of Title 66 is repealed.

Section 3. Title 66 is amended by adding a section to read:

§ 521. Retirement of electric generating units.

(a) Removal from normal operation.—No public utility shall discontinue an electric generating unit from normal operation unless it has petitioned for and obtained the approval of the commission. The commission may, upon its own motion or upon complaint, prohibit a public

utility from discontinuing an electric generating unit from normal operation if the commission determines that it would be more cost effective for the utility's ratepayers if the unit were to remain in normal operation, either with or without capital additions or operating improvements, than if the utility were to implement its plan for replacing the power which the unit is, or could be made, capable of producing.

(b) Return to normal operation.—The commission may, upon its own motion or upon complaint, order a public utility to return an electric generating unit to normal operation if the commission determines that it would be more cost effective for the utility's ratepayers if the unit were to be returned to normal operation, with or without capital additions or operating improvements, than if the utility were to implement its plan for providing the power which the unit is, or could be made, capable of producing.

(c) Procedure.—The commission may hold such hearings as it deems necessary in making the determinations required by subsection (a) or (b). The affected public utility shall have the burden of proof in any proceeding pursuant to this section.

(d) Regulations.—The commission may adopt such regulations as it deems necessary to carry out its powers and duties under this section.

(e) Exclusion.—This section shall not apply to a nuclear generating unit or to variations in operation of electric generating units to satisfy economic dispatch requirements or to maintain intrasystem or intersystem stability.

(f) Construction costs.—Notwithstanding section 1315 (relating to limitation on consideration of certain costs

for electric utilities) and subject to regulations promulgated by the commission, the commission may allow a portion of the prudently incurred costs of capital additions, determined on a per megawatt basis and not to exceed 50% of the unit's undepreciated original cost per magawatt, to an electric generating unit to be made a part of the rate base or otherwise included in the rates charged by the utility before such capital additions are completed if the commission, acting pursuant to subsection (a) or (b), prohibits the utility from retiring the unit or orders the utility to return the unit to normal operation, provided that:

(1) the capital additions would allow the continued or increased use of coal mined in Pennsylvania; and

(2) the capital additions would be more cost effective for the utility's ratepayers than other alternatives for meeting the utility's load and capacity requirements.

Notwithstanding section 1309 (relating to rates fixed on complaint; investigation of costs of production), the commission, by regulation, shall provide for a utility to remove the costs of capital additions from its rate base and to refund any revenues collected as the result of this subsection, plus interest, which shall be the average rate of interest specified for residential mortgage lending by the Secretary of Banking in accordance with the act of January 30, 1974 (P.L.13, No.6), referred to as the Loan Interest and Protection Law, during the period or periods for which the commission orders refunds, if the commission, after notice and hearing, determines that the capital addition has not been completed within a reasonable time.

(g) Definition.—As used in this section the term "normal operation" means the continuing availability of an electric generating unit to meet consumer demand except during:

(1) Scheduled outages for repairs, tests or other procedures essential to the unit's further use.

(2) Unscheduled outages caused by the unit's physical malfunctioning or breakdown.

(3) Reduced levels of generation pending execution of repairs.

(4) Reduced levels or complete cessation of generation, on a temporary basis, because of disruptions in fuel supplies, waste disposal or cooling water; or because of compliance with environmental protection limitations or conservation of fuel during periods of, or in anticipation of, scarcity.

Section 4. This act shall take effect in 60 days.

APPROVED—The 3rd day of July, A. D. 1986.

DICK THORNBURGH

No. 1986-114

AN ACT

HB 1639

Amending Title 66 (Public Utilities) of the Pennsylvania Consolidated Statutes, further providing for the appointment, terms, compensation and qualifications of and restrictions on commissioners; providing for a director of operations, the Office of Trial Staff, the Office of Special Assistants and the Director of Operations and their powers and duties; further providing for procedures, reports, budget requests and audits and for rate increase requests; providing for management efficiency investigators and for fuel purchase audits; limiting recovery of certain employee meeting expenses; making provisions relating to the sale of electric generating units; providing for the regulation of excess capacity costs and new electric generating units; restricting rate setting procedures of telephone companies; requiring that certain data be supplied by electric utilities; further regulating the recovery of advertising expenses and the recovery of club dues; authorizing the commission to order conservation and load management; regulating coin telephone service; and reestablishing the Pennsylvania Public Utility Commission.

The General Assembly of the Commonwealth of Pennsylvania hereby enacts as follows:

* * *

Section 2. Title 66 is amended by adding a section to read:

§ 321. Annual reports.

The commission shall annually transmit, to the Governor and the General Assembly and shall make available to the public, a report on the conduct of the commission. The report shall include, but shall not be limited to, a summary of all rate proceedings completed within the reporting period, the amount of the rate increase

requested in each such proceeding, the amount of the request granted by the commission in each such proceeding, the percentage increase in rates requested and granted in each such proceeding as compared to the percentage increase requested and granted in the most recent similar proceeding for the affected utility prior to the reporting period, a summary of other significant regulatory issues which the commission resolved during the reporting period, a summary of significant orders and decisions of the commission and the courts of the Commonwealth during the reporting period relating to public utilities, a summary of significant anticipated issues by type of utility and a status report of any commission action regarding these issues, and a summary of the audits completed by the commission during the reporting period. In the annual report and at such other times as the commission determines, the commission shall make recommendations to the Governor and the General Assembly which the commission believes to be necessary or desirable to protect the public interest.

* * *

Section 5. Title 66 is amended by adding sections to read:

§ 522. Expense reduction program.

(a) Target.—The commission shall establish an expense reduction program for calendar year 1986 for all electric and gas utilities with total annual intrastate operating revenues of at least $40,000,000 and for all telephone utilities with total annual intrastate operating revenues of at least $9,000,000. Utilities regulated by the commission pursuant to this subsection shall make every reasonable effort to reduce their level of expenses, other than expenses associated with depreciation, fuel, collec-

tive bargaining agreements and other categories of expense as determined by the commission for the calender year 1986 as compared to the calender year 1985. The commission shall periodically review the expense reducing efforts undertaken by utilities pursuant to this subsection and shall take appropriate action in response to these efforts.

(b) Ongoing effort.—The commission may direct or permit any utility to take any lawful action not inconsistent with this title for the purpose of encouraging economies, efficiencies or improvements which benefit the utility and its ratepayers.

§ 523. Performance factor consideration.

(a) Considerations.—The commission shall consider, in addition to all other relevant evidence of record, the efficiency, effectiveness and adequacy of service of each utility when determining just and reasonable rates under this title. On the basis of the commission's consideration of such evidence, it shall give effect to this section by making such adjustments to specific components of the utility's claimed cost of service as it may determine to be proper and appropriate. Any adjustment made under this section shall be made on the basis of specific findings upon evidence of record, which findings shall be set forth explicitly, together with their underlying rationale, in the final order of the commission.

(b) Fixed utilities.—As part of its duties pursuant to subsection (a), the commission shall set forth criteria by which it will evaluate future fixed utility performance and in assessing the performance of a fixed utility pursuant to subsection (a), the commission shall consider specifically the following:

(1) Management effectiveness and operating efficiency as measured by an audit pursuant to section

516 (relaiting to audits of certain utilities) to the extent that the audit or portions of the audit have been properly introduced by a party into the record of the proceeding in accordance with applicable rules of evidence and procedure.

(2) Action or failure to act pursuant to section 514 (relating to use of coal) to upgrade capability to use coal for electric utilities.

(3) Efficiency and cost-effectiveness of generating capacity for electric utilities.

(4) Action or failure to act to encourage development of cost-effective energy supply alternatives such as conservation or load management, cogeneration or small power production for electric and gas utilities.

(5) Action or failure to act to encourage cost-effective conservation by customers of water utilities.

(6) Action or failure to act to contain costs of constructing new generating units consistent with sections 515 (relating to construction cost of electric generating units) and 1308(f) (relating to voluntary changes in rates).

(7) Any other relevant and material evidence of efficiency, effectiveness and adequacy of service.

* * *

§ 526. Rejection of rate increase requests due to inadequate quality or quantity of service.

(a) General rule.—The commission may reject, in whole or in part, a public utility's request to increase its rates where the commission concludes, after hearing,

that the service rendered by the public utility is inadequate in that it fails to meet quantity or quality [sic] for the type of service provided.

(b) Other powers and duties preserved.—This section shall not be construed to diminish the powers and duties of the commission under any other provision of law to remedy inadequate service by a public utility.

§ 527. Cogeneration rules and regulations.

The commission shall promulgate rules and regulations concerning the rates, terms, conditions and availability of cogeneration in this Commonwealth. The commission shall require that utility rates to the public reflect savings to the utility from cogeneration.

Section 6. Section 1316 of Title 66 is amended to read:

§ 1316. Recovery of advertising expenses.

(a) General rule—For purposes of rate determinations, no [**gas or electric**] public utility may charge to its consumers as a permissible operating expense for ratemaking purposes any direct or indirect expenditure by the utility for political advertising. ***The commission shall also disallow as operating expense for ratemaking purposes expenditures for other advertising, unless and only to the extent that the commission finds that such advertising is reasonable and meets one or more of the following criteria:***

(1) Is required by law or regulation.

(2) Is in support of the issuance, marketing or acquisition of securities or other forms of financing.

(3) Encourages energy independence by promoting the wise development and use of domestic

sources of coal, oil or natural gas and does not promote one method of generating electricity as preferable to other methods of generating electricity.

(4) Provides important information to the public regarding safety, rate changes, means of reducing usage or bills, load management or energy conservation.

(5) Provides a direct benefit to ratepayers.

(6) Is for the promotion of community service or economic development.

(b) Charging expenses to stockholders.—Any direct or indirect expenditure by a [**gas or electric utility**] ***public utility*** for political advertising, ***or any other advertising not meeting the criteria set forth in subsection (a),*** shall be charged to its stockholders and shall not be included as an operating expense for ratemaking purposes.

(c) Filing of information and materials.—Whenever a public utility proposes a change in rates under section 1308 (relating to voluntary changes in rates), the public utility shall file with the commission a listing of each type of advertising prepared, distributed or presented by the public utility or to be prepared, distributed or presented by the public utility during the test year utilized by the public utility in discharging its burden of proof, and a listing of each type of advertising prepared, distributed or presented by the public utility during the year immediately preceding the test year, as well as an accounting of the expenditures by the public utility for such advertising, to the extent such advertising is proposed to be included as operating expense for ratemaking purposes. The filing requirements imposed by this subsection shall not be construed to limit the right of any party to discovery under this or any other provision of law.

[(c)] *(d)* Definition.—As used in this section the term "political advertising" means any advertising for the purpose of influencing public opinion with respect to any legislative, administrative action or candidate election or with respect to any controversial issue to be decided by public voting. The term includes money spent for lobbying but not money spent for appearances before regulatory or other governmental bodies in connection with a **[gas or electric]** public utility's existing or proposed operations.

Section 7. Title 66 is amended by adding a section to read:

§ 1316.1. Recovery of club dues.

No public utility may charge to its customers as a permissible operating expense for ratemaking purposes membership fees, dues or charges to fraternal, social or sports clubs or organizations.

* * *

§ 1321. Recovery of certain employee meeting expenses.

No public utility may charge to its customers as a permissible operating expense for ratemaking purposes any portion or portions of the direct or indirect costs of meetings, conferences, seminars or other events conducted by the utility for its employees, managers or directors which portion or portions of such costs represent expenditures for activities or items unrelated to the business or civic purpose of the event, such as costs for entertainment, recreation, athletic activities, personal clothing or other personal effects.

§ 1322. Outages of electric generating units.

(a) General rule.—Whenever an electric generating unit, determined by the commission to be a base load

unit, is out of service for more than 120 consecutive days, a utility owning a share of that unit shall not be permitted to recover, through base rates, a sliding scale of rates, or by any other means, the excess energy costs incurred to generate or purchase replacement power occasioned by any portion of the outage which the commission determines to be unreasonable or imprudent. In making its determination under this subsection, the commission shall consider, in addition to any other relevant evidence, whether the outage could have been shortened or avoided if the unit had been properly constructed, operated or maintained.

(b) Notice of outage.—Whenever an electric generating unit, determined by the commission to be a base load unit, is out of service for 45 consecutive days, any utility owning a share of that unit shall submit to the commission and the Office of Consumer Advocate a status report on that outage. The utility shall submit subsequent status reports on the outage to the commission and the Office of Consumer Advocate at least by the 20th day of each subsequent month until the unit returns to service. If more than one utility owns a share in the electric generating unit, the commission may designate one utility to make the reports required by this subsection.

(c) Operation at less than reasonable level of generation.—Whenever the actual generation of an electric generating unit, determined by the commission to be a base load unit, is less than 50% of the unit's potential generation during any calendar year or other 12-month period specified by the commission, the commission, on its own motion or upon complaint, may initiate an investigation to determine a reasonable level of generation for that unit. In establishing rates as part of that investigation or in any subsequent proceeding, the com-

mission shall not permit recovery of the excess energy costs incurred to generate or purchase replacement power occasioned by the failure of the unit to operate at or above such reasonable level of generation, if such failure is determined to be unreasonable or imprudent.

(d) Procedure.—In carrying out its powers and duties under this section, the commission may hold such hearings as it deems necessary. The utility shall have the burden of proof in any proceeding under this section.

(e) Other powers and duties preserved.—This section shall not be construed to diminish the powers and duties of the commission under any other provision of law to reduce rates in the event of an outage of an electric generating unit, regardless of the duration of that outage.

(f) Definition.—As used in this section the term "excess energy costs" means the additional costs incurred to purchase or generate replacement power minus the fuel costs which would have been incurred to generate an equivalent amount of power from the affected base load unit.

§ 1323. Procedures for new electric generating capacity.

(a) Excess capacity costs.—Whenever a public utility claims the costs of an electric generating unit in its rates for the first time and the commission finds that the unit results in the utility having excess capacity, the commission shall disallow from the utility's rates, in the same proportion as found to be excess capacity:

(1) the return on specific unit or units of any excess generating reserve;

(2) the return on the average net original cost per megawatt of the utility's generating capcity; or

(3) the equity investment in the new unit.

In addition to the disallowances set forth in this subsection, the commisson may disallow any other costs of the unit or units which the commission deems appropriate. For the purposes of this section, a rebuttable presumption is created that a unit or units or portion therof shall be determined to be excess unless found to be needed to meet the utility's customer demand plus a reasonable reserve margin in the test year or the year following the test year, or, if it is a base load unit, it is also found to produce annual economic benefits which will exceed the total annual cost of the plant during the test year or within a reasonable period following the test year.

(b) Units which are out of service.—Whenever an electric generating unit, determined by the commission to be a base load unit, is first claimed in the rates of a public utility and the unit is out of service at the time that the commission makes its final decision in the case in which the unit's costs are claimed, the commission shall make either of the following adjustments:

(1) exclude from the utility's rates all costs associated with the unit; or

(2) for a period of one year from the date of the final decision, require that the utility shall guarantee at least the level of either generation or energy savings, whichever produces the rate or rates most advantageous to the ratepayer, that the utility had estimated would be produced by the unit in the first year of its operation.

An adjustment shall be made under this subsection regardless of whether or not the new base load unit had been in service during or at the end of the test year used in the proceeding.

(c) Other powers and duties preserved.—This section shall not be construed to diminish the powers and duties of the commission under any other provision of law to reduce rates because of excess capacity or any other reason, provided that, in determining whether a base load unit, which was in commercial operation for at least one year prior to the effective date of this section, results in a public utility having excess capacity, cogeneration, for which an agreement has been entered into by the public utility within three years after the in-service date of the base load unit, shall not be considered by the commission in determining the reserve margins or economic benefits resulting from the base load unit for the first five years after the date of the cogeneration agreement.

(d) Record evidence.—Any adjustments to rates made under this section shall be made on the basis of specific findings upon evidence of record, which findings shall be set forth explicitly, together with their underlying rationale, in the final order of the commission.

* * *

Section 18. 66 Pa.C.S. § 526 (relating to rejection of rate increase requests due to inadequate quality or quantity of service) shall be applicable to all cases pending before the commission or courts, whether on appeal or otherwise.

Section 19. 66 Pa.C.S. § 1323 (relating to procedures for new electric generating capacity) shall be applicable to all cases pending before the commission.

Section 20. (a) The amendments to sections 305(a), 306 and 308(a), (b), (e) and (g) of Title 66 shall take effect in 60 days.

(b) The remainder of this act shall take effect immediately.

APPROVED—The 10th day of July, A.D. 1986.

DICK THORNBURGH